



**6714-01-P**

**FEDERAL DEPOSIT INSURANCE CORPORATION**

**12 CFR Part 380**

**RIN: 3064-AD73**

**Definition of “Predominantly Engaged in Activities That Are Financial in Nature or Incidental Thereto”**

**AGENCY:** Federal Deposit Insurance Corporation.

**ACTION:** Final Rule.

**SUMMARY:** The Federal Deposit Insurance Corporation (“FDIC”) is adopting a final rule that establishes criteria for determining if a company is predominantly engaged in “activities that are financial in nature or incidental thereto” for purposes of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or the “Act”). A company that is predominantly engaged in such activities is a “financial company” for purposes of Title II of the Act (“Title II”) unless it is one of the few entities specifically excepted by the Act. A financial company, other than an insured depository institution, may be subject to Title II’s orderly liquidation authority if, among other things, it is determined that the failure of the company and its resolution under otherwise applicable law would have serious adverse effects on financial stability in the United States.

**DATES:** This final rule is effective [INSERT DATE 30 DAYS AFTER PUBLICATION IN FEDERAL REGISTER].

## **FOR FURTHER INFORMATION CONTACT:**

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## **SUPPLEMENTARY INFORMATION:**

### **I. Background.**

Title II establishes a process for the appointment of the FDIC as receiver of a failing financial company if, among other things, its failure would otherwise have serious adverse effects on financial stability in the United States (a “covered financial company”).<sup>1</sup> Under this process, certain designated Federal regulatory authorities (herein referred to as the “recommending agencies”) must recommend to the Secretary of the Treasury (the “Secretary”) that the Secretary appoint the FDIC as receiver of the company. The recommending agencies are the Board of Governors of the Federal Reserve System (“Board of Governors”) and the Securities and Exchange Commission in consultation with the FDIC, if the company or its largest U.S. subsidiary is a broker or a dealer; the Board of Governors and the Director of the Federal Insurance Office in consultation with the FDIC, if the company or its largest U.S. subsidiary is an insurance company; and the Board of Governors and the FDIC, in all other cases.<sup>2</sup>

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<sup>1</sup> See 12 U.S.C. 5383(b).

<sup>2</sup> See 12 U.S.C. 5383(a).

Title II requires that recommendations to the Secretary include, among other things, an evaluation of whether the company is a financial company in default or in danger of default, a description of the effect that such company's default would have on the financial stability of the United States, an evaluation of why a case under the Bankruptcy Code would not be appropriate, and an evaluation of whether the company satisfies the definition of "financial company" found in section 201(a)(11) of the Act.

Upon receipt of such recommendations, the Secretary must make certain determinations in order to implement Title II's orderly liquidation authority. The Secretary shall take action to appoint the FDIC as receiver, if the Secretary (in consultation with the President) determines generally that (a) the company is a financial company in default or in danger of default; (b) the failure of the company and its resolution under otherwise applicable Federal or State law would have serious adverse effects on financial stability in the United States; (c) no viable private sector alternative is available to prevent the default; (d) any effect on the claims or interests of creditors, counterparties, and shareholders is appropriate; (e) any action under the liquidation authority will avoid or mitigate such adverse effects taking into consideration the effectiveness of the action in mitigating the potential adverse effects on the financial system, the cost to the general fund of the Treasury, and the potential to increase excessive risk taking; (f) a Federal regulatory agency has ordered the company to convert all of its convertible debt instruments that are subject to regulatory order; and (g) the company satisfies the definition of a financial company under Title II.<sup>3</sup>

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<sup>3</sup> See 12 U.S.C. 5383(b).

If the board of directors (or similar governing body) of the financial company consents to the appointment, the FDIC's appointment as receiver becomes effective immediately. However, if the company's governing body does not consent to the appointment, the Secretary must petition the United States District Court for the District of Columbia for an order authorizing the appointment of the FDIC as receiver. The Court will determine whether the Secretary's determinations that the financial company is in default or in danger of default and that it satisfies the definition of financial company under Title II are arbitrary and capricious. If the Court finds that the Secretary's determinations are not arbitrary and capricious, it will issue an order authorizing the Secretary to appoint the FDIC as receiver.<sup>4</sup> If the Court does not make a determination within twenty-four hours of receiving the petition, then the appointment of the FDIC occurs by operation of law.

Section 201(a)(11) of the Act defines "financial company" for purposes of Title II as any company incorporated or organized under any provision of Federal law or the laws of any State that is: (i) a bank holding company, as defined in section 2(a) of the Bank Holding Company Act of 1956 ("BHC Act")<sup>5</sup>; (ii) a nonbank financial company supervised by the Board of Governors; (iii) any company that is predominantly engaged in activities that the Board of Governors has determined are financial in nature or

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<sup>4</sup> If the Court overrules the Secretary's determination, the Secretary is provided the opportunity to amend and refile the petition immediately. Title II includes appeal provisions, but does not provide for a stay of the actions taken by the receiver after its appointment.

<sup>5</sup> 12 U.S.C. 1841(a).

incidental thereto for purposes of section 4(k) of the BHC Act (“section 4(k)”);<sup>6</sup> or (iv) any subsidiary of any of the aforementioned companies that is predominantly engaged in activities that the Board of Governors has determined are financial in nature or incidental thereto for purposes of section 4(k), other than a subsidiary that is an insured depository institution or an insurance company.<sup>7</sup>

Section 201(b) of the Act provides that, for the purposes of defining the term “financial company” under section 201(a)(11), “no company shall be deemed to be predominantly engaged in activities that the Board of Governors has determined are financial in nature or incidental thereto for purposes of section 4(k) of the [BHC Act], if the consolidated revenues of such company from such activities constitute less than 85 percent of the total consolidated revenues of such company, as the Corporation, in consultation with the Secretary, shall establish by regulation. In determining whether a company is a financial company under [Title II], the consolidated revenues derived from the ownership or control of a depository institution shall be included.”<sup>8</sup> A company that is predominantly engaged in such activities is a “financial company” under Title II (unless it is one of the few entities expressly excepted under section 201(a)(11) of the Act) and may be subject to the orderly liquidation provisions of Title II following certain determinations by the Secretary, as discussed above.

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<sup>6</sup> 12 U.S.C. 1843(k).

<sup>7</sup> Section 201(a)(11) also provides that “financial company” does not include Farm Credit System institutions chartered under and subject to the provisions of the Farm Credit Act of 1971, as amended (12 U.S.C. 2001 et seq.), or governmental or regulated entities as defined under section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4502(20)).

<sup>8</sup> 12 U.S.C. 5381(b).

While section 201(b) of the Act required the FDIC to issue a rule establishing the criteria for determining whether a company is predominantly engaged in activities that are financial in nature or incidental thereto for purposes of Title II, section 102(b) of the Act required the Board of Governors to issue a regulation establishing the criteria for determining whether a company is predominantly engaged in financial activities for purposes of Title I. Both sections 102(b) and 201(b) of the Act indicate that the determination of whether an activity is financial is based upon section 4(k), and since the Board of Governors is the agency with primary responsibility for interpreting and applying section 4(k), the FDIC coordinated its rulemaking pursuant to section 201(b) of the Act with the Board of Governors' rulemaking pursuant to section 102(b) of the Act.

In accordance with the authority granted to it by section 102(b), the Board of Governors published on February 11, 2011, a notice of proposed rulemaking titled "Definitions of 'Predominantly Engaged in Financial Activities' and 'Significant' Nonbank Financial Company and Bank Holding Company" ("Board of Governors' first NPR").<sup>9</sup> The Board of Governors' first NPR proposed criteria for determining whether a company is "predominantly engaged in financial activities" for purposes of determining if the company is a nonbank financial company under Title I of the Act.<sup>10</sup> The Board of Governors' first NPR generally defined the term "financial activity" by reference to 12 CFR 225.86 and section 4(k)(1)(A) of the BHC Act. 12 CFR 225.86 lists each activity

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<sup>9</sup> 76 FR 7731 (February 11, 2011).

<sup>10</sup> Under section 113 of the Act, the Financial Stability Oversight Council ("Council") may designate a nonbank financial company for supervision by the Board of Governors if the Council determines that material financial distress of the company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the company's activities, could pose a threat to the financial stability of the United States.

that the Board of Governors has determined is financial in nature or incidental thereto. Section 4(k)(1)(A) of the BHC Act provides authority for additional activities to be designated as financial in nature or incidental thereto.

On March 23, 2011, the FDIC published a notice of proposed rulemaking in the Federal Register titled “Orderly Liquidation Authority” (“FDIC’s first NPR”).<sup>11</sup> The FDIC’s first NPR was intended to provide clarity and certainty with respect to how key components of the orderly liquidation authority would be implemented and to ensure that the liquidation process under Title II reflects the Act’s mandate of transparency with respect to the liquidation of covered financial companies. The FDIC’s first NPR proposed, among other things, criteria for determining if a company is predominantly engaged in activities that are financial in nature or incidental thereto for purposes of Title II.

These criteria were set forth in section 380.8 of the FDIC’s first NPR (“section 380.8”). Section 380.8 generally provided that a company is predominantly engaged in financial activities for purposes of Title II if: (i) at least 85 percent of the total consolidated revenues of the company for either of its two most recent fiscal years were derived, directly or indirectly, from financial activities, or (ii) based upon all the relevant facts and circumstances, the FDIC determines that the consolidated revenues of the company from financial activities constitute 85 percent or more of the total consolidated revenues of the company. Like the Board of Governors’ first NPR, the FDIC’s first NPR defined the term “financial activity” by reference to 12 CFR 225.86 and section

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<sup>11</sup> 76 FR 16324 (March 23, 2011).

4(k)(1)(A), and also included ownership or control of depository institutions. The FDIC adopted provisions of the FDIC's first NPR other than section 380.8 in a final rule published in the Federal Register on July 15, 2011.<sup>12</sup>

On April 10, 2012, the Board of Governors published a supplemental notice of proposed rulemaking ("Board of Governors' second NPR") that amended the definition of financial activities set forth in the Board of Governors' first NPR.<sup>13</sup> The Board of Governors' second NPR was published in response to comments that raised questions as to whether engaging in certain financial activities in a manner that does not comply with certain conditions and limitations applicable to the conduct of such activities by bank holding companies should nevertheless be considered to be financial activities for purposes of Title I of the Act. The Board of Governors' second NPR proposed an appendix that listed the activities that it considered to be financial activities, including conditions that the Board of Governors had determined were necessary to define the activity as "financial" for purposes of Title I of the Act, but excluding conditions that were imposed, either by section 4(k) or the Board of Governors' regulations, on the conduct of the activity by a bank holding company for reasons such as safety and soundness or compliance with other applicable law.

On June 18, 2012, the FDIC published in the Federal Register and requested comment on a supplemental notice of proposed rulemaking that clarified the scope of the activities that would be considered "financial activities" for purposes of Title II ("FDIC's second NPR"). The FDIC's second NPR proposed to adopt the list of activities that the

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<sup>12</sup> 76 FR 41626 (July 15, 2011).

<sup>13</sup> 77 FR 21494 (April 10, 2012).



Board of Governors' second NPR determined are "financial in nature" for purposes of Title I. Similar to the Board of Governors' list, the FDIC's list of financial-in-nature activities included those conditions determined by the Board of Governors to be necessary to define the activity, but excluded those conditions that were imposed on the conduct of the activity by a bank holding company for reasons of safety and soundness or compliance with other law. The FDIC is now adopting as final the criteria proposed in the FDIC's first NPR, as amended by the FDIC's second NPR, with certain modifications. As discussed in more detail below, the FDIC received 8 comments in response to the FDIC's first NPR that addressed the proposed section 380.8 and 7 comments in response to the FDIC's second NPR.

## **II. Explanation of the Final Rule.**

In developing the final rule, the FDIC considered the comments it received in response to both the FDIC's first NPR and the FDIC's second NPR, consulted with the Secretary's staff as required by section 201(b) of the Act, and coordinated with the Board of Governors' staff. The FDIC also considered the Board of Governors' final rule defining the term "predominantly engaged in financial activities" for purposes of Title I that was published in the Federal Register on April 5, 2013 ("Board of Governors' final rule").<sup>14</sup> The FDIC's final rule includes several modifications to the FDIC's first NPR and the FDIC's second NPR, discussed further below, that are intended to address matters raised by commenters.

### **A. Predominantly Engaged in Financial Activities**

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<sup>14</sup> 78 FR 20756 (April 5, 2013).

## **1. The Revenue Tests**

As noted above, section 380.8 as proposed in the FDIC's first NPR provided that a company is predominantly engaged in financial activities if: (i) at least 85 percent of the total consolidated revenues of the company for either of its two most recent fiscal years were derived, directly or indirectly, from financial activities ("two-year test"), or (ii) based upon all the relevant facts and circumstances, the FDIC determines that the consolidated revenues of the company from financial activities constitute 85 percent or more of the total consolidated revenues of the company ("facts and circumstances analysis")(collectively, the "revenue tests"). Under the FDIC's first NPR, a company would not be considered to be predominantly engaged in financial activities if the level of such company's financial revenues was below 85 percent of its total consolidated revenues in both of its two most recent fiscal years. The FDIC's first NPR defined "total consolidated revenues" as the total gross revenues of a company and all entities subject to consolidation by the company for a fiscal year, as determined in accordance with applicable accounting standards.

The FDIC received three comments that discussed the revenue tests found in section 380.8(a) of the FDIC's first NPR. These commenters were generally in favor of the proposal. One comment, for example, stated that both the two-year test and the facts and circumstances analysis for FDIC determinations found in section 380.8(a) carry out the statutory mandates for Title II and are flexible enough as not to impose any unnecessary regulatory burden.

A second commenter supported the two-year test, but expressed the opinion that the facts and circumstances analysis should be removed from a final rule. This

commenter suggested that a facts and circumstances analysis is inappropriate with respect to the orderly liquidation authority because of the uncertainty it would create.

The FDIC recognizes the importance of providing certainty with respect to the calculation for determining if a company meets either of the revenue tests. However, the FDIC notes that the mix of a company's revenues may change significantly and quickly as a result of various types of transactions or actions, such as a merger, consolidation, acquisition, establishment of a new business line, or the initiation of a new activity. Moreover, these transactions and actions may occur at any time during a company's fiscal year and, accordingly, the effects of the transactions or actions may not be reflected in the year-end consolidated financial statements of the company for several months. Consequently, the facts and circumstances analysis is necessary in order to promptly consider the effect of changes in the nature or mix of a company's activities as a result of such transactions or actions. For these reasons, the final rule retains a two-year test and a facts and circumstances analysis.

However, the final rule removes the reference to the FDIC as the entity that will apply the facts and circumstances analysis. This change was made in recognition of the provisions of section 203 of the Act, which provide that the Federal authorities that will apply these revenue tests are the recommending agencies, for purposes of the evaluations under section 203(a) of the Act, and the Secretary, for purposes of the determination pursuant to section 203(b) of the Act.

## **2. Scope of companies that are predominantly engaged in activities that are financial activities for purposes of Title II**

A number of the comments received by the FDIC addressed the scope of section 380.8 and whether certain companies should be eligible for resolution under Title II. For example, one commenter stated that the list of companies eligible for consideration as systemically important should include as many large or interconnected nonbank financial firms that pose systemic risk to the financial system as possible. This commenter suggested that such a list should include, but not be limited to, large investment banks, insurance companies, hedge funds, private equity funds, venture capital firms, mutual funds, industrial loan companies, special purpose vehicles, and nonbank mortgage origination companies.

Other commenters suggested that certain types of companies should be expressly excluded from the orderly liquidation authority. One commenter, for example, expressed concerns that section 380.8 did not exclude insurers and insurance companies. One commenter argued that money market mutual funds and similar self-liquidating entities should be excluded. Another commenter argued that excluding money market mutual funds from the definition of financial company for Title II purposes would be appropriate due to the fact that such funds are already subject to “consolidated supervision and/or heightened reporting requirements” established by the Securities and Exchange Commission. Two other commenters expressed the opinion that the FDIC’s orderly liquidation authority should be limited to institutions that are designated as systemically important under Title I of the Act.

Similarly, two commenters sought clarification that certain entities would be excluded from the definition of financial company under Title II due to their activities being deemed nonfinancial for purposes of the FDIC’s second NPR. One commenter

sought clarification as to whether the activities of a Nationally Recognized Statistical Rating Organization (“NRSRO”) would constitute investment advisory activities under section 380.8(b)(2)(xi)(B) of the FDIC’s second NPR and therefore, financial activities. Another commenter sought clarification with respect to the activities of credit unions.

After considering these comments, the FDIC determined it would be inappropriate to exclude specific types of entities (other than those expressly excluded by section 201(a)(11)) from the definition of “financial company” for purposes of Title II. Title II is clearly intended to apply not only to bank holding companies and nonbank financial companies supervised by the Board of Governors, but to other financial companies as well. With a limited exception,<sup>15</sup> section 201(a)(11) contains no express exclusion for insurance companies, money market mutual funds, NRSROs, credit unions, or any other companies, nor any suggestion that such exclusions were intended. Furthermore, the express exclusion of certain types of companies implies that Congress intended no other exclusions.

In addition, sections 202 and 203 of the Act provide the process for making a systemic risk determination with respect to a financial company and for determining that a financial company is subject to orderly liquidation under Title II. As discussed in section I of this Preamble, that process includes an evaluation of several factors. The FDIC believes that systemic risk determinations are appropriately considered in the recommendation, determination, and judicial review stages of the orderly liquidation

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<sup>15</sup> See 12 U.S.C. 5381(a)(11)(B)(iv), Section 201(a)(11)(B)(iv) of the Dodd-Frank Act, excepts from the definition of “financial company” an insurance company that is a subsidiary of a bank holding company, a nonbank financial company supervised by the Board of Governors, or a company that meets the “predominantly engaged” test in section 201(a)(11)(B)(iii).

process described in sections 202 and 203 of the Act. Furthermore, the FDIC believes that the scope of the companies that would be subject to Title II should not be limited by regulation in a manner that is inconsistent with the purposes of Title II.

### **3. Activities that are Financial in Nature or Incidental Thereto**

Under section 201(a)(11) of the Act, the determination of whether a company (other than a bank holding company or a nonbank financial company supervised by the Board of Governors) is predominantly engaged in financial activities for purposes of Title II is based upon activities that the Board of Governors has determined are “financial in nature or incidental thereto” under section 4(k). As noted above, the FDIC’s first NPR defined “financial activity” to include: (i) any activity, wherever conducted, described in section 225.86 of the Board of Governors’ Regulation Y (“Regulation Y”) or any successor regulation;<sup>16</sup> (ii) ownership or control of one or more depository institutions; and (iii) any other activity, wherever conducted, determined by the Board of Governors in consultation with the Secretary, under section 4(k)(1)(A) of the BHC Act,<sup>17</sup> to be financial in nature or incidental to a financial activity.

Two commenters discussed the definition of “financial activity” found in the FDIC’s first NPR and expressed the opinion that the activities that should be considered “financial” are appropriately listed in section 225.86 of Regulation Y. The first commenter supported including those activities that have been considered by the Board

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<sup>16</sup> See 12 CFR 225.86.

<sup>17</sup> See 12 U.S.C. 1843(k)(1)(A).

of Governors as “closely related to banking” and that are listed in sections 225.28(b) and 225.86(a)(2) of Regulation Y.<sup>18</sup> The commenter also stated that the proposed rule should broadly define “financial activities” to include all activities that have been, or may be, determined to be financial in nature under Section 4(k), regardless of, (i) where the activity is conducted, (ii) whether a bank holding company or foreign banking organization could conduct the activity under some legal authority other than section 4(k), and (iii) whether any Federal or state law other than section 4(k) may prohibit or restrict the conduct of the activity by a bank holding company.

One commenter asserted that the FDIC’s first NPR failed to define the terms used in Title II in a way that provides clarity with respect to what companies can be designated or the standards that will be considered and applied in making a designation.

One commenter noted that many of the activities that are financial in nature or incidental thereto as proposed in the FDIC’s first NPR are not of obvious systemic significance to the financial system. The commenter argued that a company that derives 85 percent or more of its revenues from providing management consulting services, check-courier services, or website security certificate services would be a financial company, but would be an inappropriate candidate for resolution under the orderly liquidation authority of Title II. This commenter suggested that the FDIC include a discussion of the importance of systemic concerns in the Title II context, similar to the emphasis placed on systemic concerns in the Title I prudential-supervision context, in order to assure financial markets of the accurate applicability of the proposed rule.

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<sup>18</sup> 12 CFR 225.28(b); 225.86(a)(2).

The FDIC notes that before a financial company can be resolved under Title II, section 203 of the Act requires a determination that the failure of the financial company and its resolution under otherwise applicable law would have serious adverse effects on financial stability in the United States. Moreover, this rule is limited to establishing criteria pursuant to section 201(b) for making a revenue calculation to determine whether a company is predominantly engaged in financial activities for purposes of Title II.

In response to the comments received and in an effort to provide greater clarity, the FDIC published and requested comment on the FDIC's second NPR, which proposed to amend the FDIC's first NPR to further refine the definition of financial activities for purposes of Title II. The comments that the FDIC received in response to the FDIC's second NPR are discussed below.

In the preamble to the FDIC's second NPR, the FDIC acknowledged several important reasons why the term "financial in nature" under Title II should have the same meaning as it does for purposes of Title I. First, any interpretation of "financial in nature" under section 4(k) that is inconsistent with the Board of Governors' interpretation could frustrate Congressional intent regarding Title II. Section 204 of the Dodd Frank Act states that the intent of Title II is to provide for the liquidation of failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard. Based upon this expression of Congressional intent regarding Title II, and given that one of the goals of Title I is to provide the authority to require the supervision of certain nonbank financial companies that could pose a threat to the financial stability of the United States, the FDIC believes that both of these goals can be achieved in a manner consistent with Congressional goals



if such a key term as “financial in nature” is given the same meaning in both Titles I and II. The FDIC believes that it is important that Titles I and II work together in a manner that provides a coherent framework for monitoring and supervising the operation of financial companies whose failure could have a serious adverse effect on the financial stability of the United States, and for liquidating those companies with the least disruption to the U.S. financial stability, if any should fail. Second, utilizing in Title II an interpretation of “financial in nature” that is inconsistent with the Title I interpretation could result in confusion on the part of companies that may be subject to either or both of Titles I and II. For example, if the interpretations are different, a company may rely on the Title I interpretation of “financial in nature” to incorrectly conclude that it is not subject to Title II’s orderly liquidation authority. Conversely, a company may use the Title II interpretation of “financial in nature” to incorrectly conclude that it is not eligible under the Council’s Title I authority to be supervised by the Board of Governors and subject to enhanced prudential standards.

For these reasons, the FDIC’s second NPR proposed to amend the FDIC’s first NPR, consistent with the Board of Governors’ second NPR and the purposes of Title II, to define the term “financial activity” to include each activity referenced in section 4(k) that the Board of Governors has determined is financial in nature or incidental thereto but to exclude the conditions or limitations that are imposed on bank holding companies engaged in such activities that do not define the essential nature of the activity itself.<sup>19</sup>

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<sup>19</sup> As noted in the Board of Governors’ second NPR, conditions that do not define the activity itself include those conditions that were imposed to ensure that a bank holding company that conducts the activity does so in a safe and sound manner or to comply with another provision of law. *See* 77 FR 21494 (April 10, 2012).

#### A. Scope of Financial Activities

The FDIC received comments addressing whether the amendments contained in the FDIC's second NPR were appropriate. While most commenters supported the amended definition of financial activities contained in the FDIC's second NPR, one commenter expressed a number of concerns with the FDIC's interpretation of the Act and argued that the clarification of financial activities in the FDIC's second NPR exceeds the rulemaking authority granted to the FDIC under Title II. This commenter suggested that the FDIC's second NPR should not be based upon the Board of Governors' second NPR, which the commenter asserted is flawed and exceeds the statutory authority granted to the Board of Governors by Title I.

In contrast, another commenter supported adoption of the amendments proposed in the FDIC's second NPR as they would reduce the possibility that systemically significant financial firms would be insulated from the reach of the orderly liquidation authority under Title II. This commenter argued that the inclusion of the non-definitional conditions from section 4(k) and Regulation Y into section 380.8 would raise the possibility that a firm could be predominantly engaged in financial activities, but immune from orderly liquidation authority resolution because the company's activities may not comply with such conditions.

As noted earlier, section 201(b) of the Act authorizes the FDIC to establish, in consultation with the Secretary, standards for determining if a company is “predominantly engaged in activities that the Board of Governors has determined are financial in nature or incidental thereto for purposes of section 4(k)....” The

identification of the scope of activities that the Board of Governors has determined are financial in nature or incidental thereto for purposes of section 4(k) is a necessary requirement for determining whether a company is predominantly engaged in such activities for purposes of Title II.

Section 4(k), which was added to the BHC Act by the Gramm-Leach-Bliley Act (“GLB Act”), authorizes bank holding companies that qualify as “financial holding companies” to engage in a wide range of financial activities.<sup>20</sup> Section 4(k) defines as “financial” a list of activities that includes Congressionally-authorized activities added by the GLB Act as well as activities that had been previously approved by the Board of Governors for bank holding companies pursuant to sections 4(c)(8) and 4(c)(13) of the BHC Act, which are incorporated by reference. As discussed in the FDIC’s second NPR, section 4(k) and the Board of Governors’ Regulation Y which, in part, implements sections 4(c)(8) and 4(c)(13) also impose conditions on the conduct of some of those activities for safety and soundness reasons or to ensure compliance with other laws. Some of the Congressionally-authorized activities for financial holding companies, such as lending, overlap completely with activities that had been authorized by the Board of Governors for bank holding companies. Other Congressionally-authorized activities expanded the authorization of activities previously approved by the Board of Governors for bank holding companies, such as certain insurance activities, by removing the conditions that apply to bank holding companies engaging in the activity. Bank holding

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<sup>20</sup> 12 U.S.C. 1843(l)(1). To engage in the board range of activities authorized by section 4(k), a bank holding company must be well-capitalized and well-managed, and its subsidiary insured depository institutions must also be well-capitalized and well-managed and have ‘satisfactory’ ratings under the Community Reinvestment Act.

companies that are not financial holding companies may only engage in activities previously approved by the Board of Governors under sections 4(c)(8) and 4(c)(13) of the BHC Act and are subject to certain conditions.

While section 4(k) and Regulation Y are clear with respect to the type and scope of activities that are permissible for both financial holding companies and bank holding companies, section 201(b) is silent as to how the overlapping definitions of financial activities and the conditions incorporated in section 4(k) should be applied in determining whether companies that are not subject to the BHC Act are predominantly engaged in financial activities for purposes of Title II. Because sections 201(a)(11) and 201(b) of the Act do not address how to apply these overlapping and sometimes inconsistent definitions of financial activities or how to apply the conditions incorporated in section 4(k) and the Board of Governors' implementing regulations, the references in sections 201(a)(11) and 201(b) of the Act to activities that the Board of Governors has determined are financial in nature or incidental thereto for purposes of section 4(k) are ambiguous. This conclusion is consistent with the Board of Governors' conclusion with respect to Title I.

As discussed in the preamble to the Board of Governors' final rule, the statutory references to section 4(k) are ambiguous when applied to companies other than bank holding companies. Since sections 201(a)(11) and 201(b) also reference section 4(k) in determining whether a company is predominantly engaged in financial activities for purposes of Title II, these same ambiguities that exist in Title I also exist in Title II. The Board of Governors is the Federal agency charged with interpreting and applying section 4(k). Consequently, the Board of Governors' resolution of those ambiguities is a critical

guide in applying section 4(k) to companies other than bank holding companies for purposes of Title II. Consistent with the Board of Governors' approach, this ambiguity can be resolved by reference to relevant case law. Under Supreme Court precedent, a statutory term defined by cross-reference to another statute is not alone evidence of clear Congressional intent that the implementing agency construe the term identically. In Environmental Defense v. Duke Energy Corp.<sup>21</sup> ("Duke"), the Court held that the general presumption of statutory construction "that the same term has the same meaning when it occurs here and there in a single statute," may be overcome where context indicates that the term was intended to be construed differently.<sup>22</sup>

Consistent with the Court's analysis in Duke, the FDIC believes that neither the text, the context in which the text appears, nor the legislative purpose or history of the Dodd-Frank Act suggests that Congress intended that a nonbank company must engage in financial activities in compliance with all the conditions and requirements imposed under section 4(k) and the Board of Governors' implementing regulations in order for the company to be considered to be engaged in the relevant financial activity. A reading of Title II that limits the scope of companies considered to be "predominantly engaged" in financial activities to only those companies that conduct activities in compliance with the

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<sup>21</sup> 549 U.S. 561 (2007).

<sup>22</sup> See id. at 574, 576, citing Atlantic Cleaners & Dyers, Inc. v. United States, 286 U.S. 427, 433. The Court considered whether the Environmental Protection Agency ("EPA") was required to interpret the term "modification" identically where one section of the Clean Air Act ("CAA") defined "modification" "as defined in" a different section of the CAA. The Court held that when considering whether a term that is used in different statutes must be interpreted identically, "context counts." See id. at 575-76, citing United States v. Cleveland Indians Baseball Co., 532 U.S. 200, 213 (2001). The Court considered the context in which the term "modification" was used and the legislative history of the relevant statutory provisions and found no evidence of Congressional intent that "modification" be construed identically by the EPA despite the cross-reference to the term in the statute because the contexts in which the term was used and the purposes of each use were different.

conditions applicable to bank holding companies would undermine the purpose of Title II and the authority granted by Congress to the Secretary to order the resolution under Title II of an organization whose failure might reasonably threaten U.S. financial stability.<sup>23</sup> Moreover, defining financial activities for purposes of Title II to include all of the conditions imposed on the conduct of the activities by bank holding companies for purposes of safety and soundness or to ensure their compliance with other laws would lead to an absurd result. Specifically, some companies that are predominantly engaged in financial activities could avoid orderly liquidation under Title II simply by choosing not to abide by one or more of these conditions that are unrelated to whether the activity is a financial activity.

Furthermore, the FDIC also continues to believe that it is important that the definition of “financial activities” for purposes of Title II remain as similar as practicable to the definition of “financial activities” for purposes of Title I. In both the FDIC’s first NPR and the FDIC’s second NPR, the FDIC noted the benefits and importance of maintaining symmetry with the definition in Title I. For example, utilizing in Title II an interpretation of “financial in nature” that is inconsistent with the Title I interpretation could result in confusion on the part of companies that may be subject to either or both of Titles I and II. As noted above, the FDIC believes that it is important that Titles I and II work together in a manner that provides a coherent framework for monitoring and supervising the operation of financial companies whose failure could have a serious

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<sup>23</sup> See Committee on Banking, Housing, and Urban Affairs Report, S. Rep. No. 111-176, April 30, 2010, page 5, citing Testimony of Timothy Geithner, Secretary of the Treasury, to the Banking Committee, June 18, 2009.

adverse effect on the financial stability of the United States, and for liquidating such companies with the least disruption to the U.S. financial stability, if any should fail. The FDIC received a number of comments in response to both the FDIC's first NPR and the FDIC's second NPR that supported this approach. For these reasons, the FDIC believes that consistency, to the extent possible, with the Board of Governors' interpretation of what constitutes "financial activities" for purposes of Title I is appropriate. As discussed in further detail below, the FDIC has determined that the modifications adopted by the Board of Governors in its final rule were appropriate and consistent with the purposes and goals of Title II and has therefore adopted them in this final rule.

**B. Description of "Financial Activities"**

As an initial matter, the FDIC notes that the only purpose of this rulemaking is to establish criteria for determining which activities are financial. This rulemaking does not designate any specific entity for resolution under Title II. As discussed earlier in section I of this Preamble, sections 202 and 203 of the Act govern the appointment of the FDIC as receiver for a covered financial company. Under those sections, the authority to appoint the FDIC as receiver of a financial company rests with the Secretary, in consultation with the President.

The final rule retains the approach set forth in the FDIC's second NPR with certain modifications, including, the restoration of several conditions that the FDIC proposed to remove in the FDIC's second NPR. These conditions are the same conditions that were reinstated in the Board of Governors' final rule defining "financial activities" for purposes of Title I, and one condition related to finder activities. As discussed in more detail below, the FDIC restored conditions relating to the activities of

providing agency transactional services, engaging as principal in derivative transactions, data processing, management consulting services, investing as part of a bona fide underwriting, or merchant or investment banking activity, and acting as a finder. The final rule also retains all of the conditions set forth in the description of the financial activities listed in section 4(k), other than two conditions with respect to bona fide underwriting or merchant or investment banking activities, and one with respect to insurance company portfolio investments, which do not define the activity itself. This approach in the final rule is consistent with the Board of Governors' final rule.

Because section 4(k) references financial activities that were authorized by the Board of Governors under various authorities at different points in time, certain of the financial activities listed below overlap with, or are wholly subsumed by, other financial activities permissible for financial holding companies. The FDIC did not receive any comments in response to the FDIC's second NPR that addressed overlapping and redundant activities. To reduce the ambiguity, however, created by the overlapping and redundant descriptions, the final rule, like the Board of Governors' final rule, provides that a company that engages in a particular activity in a manner that does not comply with the narrower definition of the particular activity will be considered to be engaged in a financial activity if its activities are captured by the broader description of the activity. Consistent with the FDIC's second NPR, the final rule includes such overlapping and redundant activities, in order to ensure completeness.

#### **1. Financial activities added to the BHC Act by the Gramm–Leach–Bliley Act**



The following financial activities were authorized for financial holding companies and added to section 4(k) by the Gramm–Leach–Bliley Act (“GLB Act”).

- ***Lending, exchanging, transferring, investing for others, and safeguarding money or securities***

The activities of lending, exchanging, transferring, investing for others, or safeguarding money or securities are specifically enumerated, without conditions, in section 4(k).<sup>24</sup> The Board of Governors’ determined that the activity of “investing for others” includes buying, selling, or otherwise acquiring and disposing of money or securities in order to benefit from changes in the value of those assets and distribute profits to investors. These activities are often conducted by investment advisors, wealth managers, limited purpose trust companies, mutual funds, hedge funds, private equity funds, real estate investment trusts, and similar vehicles.

One commenter argued that open-end investment companies (e.g., mutual funds) are not engaged in financial activities as defined in section 4(k) of the BHC Act. However, the Board of Governors’ regulations have long authorized bank holding companies to engage in organizing, sponsoring, and managing mutual funds and closed-end investment companies and to serve as an investment adviser to mutual funds and closed-end investment companies and others using the authority described in section 4(k).<sup>25</sup> Prior to enactment of the GLB Act in 1999, the Board of Governors permitted bank holding companies to own more than 5 percent (and up to 25 percent) of the shares

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<sup>24</sup> 12 U.S.C. 1843(k)(4)(A).

<sup>25</sup> See, e.g., 12 CFR 211.10(a)(11); 225.28(b)(6)(i); 225.86(b)(3); and 225.125. See also, e.g., Mellon Bank Corporation, 79 Federal Reserve Bulletin 626 (1993), and Bayerische Vereinsbank AG, 73 Federal Reserve Bulletin 155 (1987).

of an open-end investment company—a determination that represents a finding that open-end investment companies engage in a financial activity.<sup>26</sup> The investment limitation reflects a decision by the Board of Governors that the public benefits of allowing a bank holding company to own more than 25 percent of the shares of a mutual fund did not outweigh the potential costs consequent with treating the mutual fund as a subsidiary of the bank holding company. Under the BHC Act, the decision to allow a bank holding company to own more than 5 percent of the shares of a mutual fund is sufficient to indicate that the mutual fund itself, which is a company, is engaged in a financial activity.<sup>27</sup> The activity of organizing, sponsoring, and managing a mutual fund was also determined to be usual in connection with the transaction of banking or other financial operations abroad prior to November 11, 1999, and, thus, is incorporated as a financial activity in section 4(k) by the GLB Act.<sup>28</sup> The Board of Governors’ regulations prohibit bank holding companies from exerting managerial control over the companies in which the mutual fund invests and require bank holding companies to reduce their ownership to less than 25 percent of the equity of the mutual fund within one year of sponsoring the fund.<sup>29</sup> These limitations were imposed to prevent circumvention of the investment restrictions in the BHC Act.

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<sup>26</sup> See letter dated June 24, 1999, to H. Rodgin Cohen, Esq., Sullivan & Cromwell (First Union Corporation), from Jennifer J. Johnson, Secretary of the Board of Governors of the Federal Reserve System. See also 12 CFR 225.86(b)(3).

<sup>27</sup> Bank holding companies are generally prohibited from owning more than 5 percent of the voting shares of a company unless that company is engaged only in a financial activity. See 12 U.S.C. 1843(a).

<sup>28</sup> 12 U.S.C. 1843(k)(4)(G); 12 CFR 225.86(b)(3).

<sup>29</sup> 12 CFR 225.86(b)(3).

Moreover, section 4(k) itself authorizes all of the component activities in which a mutual fund engages — investing for others,<sup>30</sup> merchant banking,<sup>31</sup> investment advice,<sup>32</sup> and underwriting<sup>33</sup> — as financial. These activities are defined as financial under section 4(k) separately from, and in addition to, those activities previously approved by the Board of Governors as being so closely related to banking as to be a proper incident thereto, or usual in connection with the transaction of banking or other financial operations abroad, which are incorporated into the definition of financial activities in section 4(k).<sup>34</sup>

Section 4(k) specifically defines the activities of underwriting, dealing in, or making a market in securities as a financial activity, which includes key components of sponsoring and distributing shares of mutual funds and investment companies. Section 4(k) also specifically enumerates as financial activities providing financial, investment, and economic advisory services and investing for others, which includes buying, selling, or otherwise acquiring and disposing of money or securities in order to benefit from changes in the value of those assets and distributing the profits to investors. Similarly, section 4(k) authorizes merchant banking activities—which represent investments made for the purpose of profiting from price appreciation—as financial.

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<sup>30</sup> 12 U.S.C. 1843(k)(4)(A).

<sup>31</sup> 12 U.S.C. 1843(k)(4)(H).

<sup>32</sup> 12 U.S.C. 1843(k)(4)(C).

<sup>33</sup> 12 U.S.C. 1843(k)(4)(E).

<sup>34</sup> In amending Regulation Y consistent with the GLB Act, the Board of Governors added the financial activities added to section 4(k) by the GLB Act and noted that in light of the passage of the GLB Act “securities underwriting, dealing, and market making . . . is authorized for financial holding companies in a broader form” than had previously been permitted. See 65 FR 14440, 14443, 14435 (March 17, 2000).

The fact that the Board of Governors has imposed prudential conditions on bank holding companies engaged in the activity of organizing, sponsoring, or managing a mutual fund does not negate the fact that the activity is financial for purposes of section 4(k).<sup>35</sup>

- ***Insurance activities***

Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any state, are financial activities specifically enumerated in section 4(k).<sup>36</sup>

- ***Financial, investment, and economic advisory services***

Financial, investment, and economic advisory services are financial activities specifically enumerated in section 4(k).<sup>37</sup> These activities may be provided individually or in combination and include discretionary and non-discretionary investment advisory activities. This broad authorization to provide financial, investment, or economic advisory services also includes activities that the Board of Governors determined were closely related to banking. For example, the Board of Governors previously determined that acting as an investment or financial advisor to any person was closely related to

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<sup>35</sup> As noted previously, bank holding companies are generally prohibited from owning more than 5 percent of the voting shares of a company unless that company is engaged only in a financial activity. See 12 U.S.C. 1843(a).

<sup>36</sup> 12 U.S.C. 1843(k)(4)(B). In amending Regulation Y, the Board of Governors noted that section 4(k)(4) authorized financial activities, including “activities that previously have not been permissible for bank holding companies, such as acting as principal, agent, or broker for purposes of insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, and issuing annuity products. Permissible insurance activities as principal include reinsuring insurance products. A financial holding company acting under that section may conduct insurance activities without regard to the restrictions on the insurance activities imposed on bank holding companies under section 4(c)(8).” See 65 FR 14433, 14435 (March 17, 2000).

<sup>37</sup> 12 U.S.C. 1843(k)(4)(C).

banking, including, without limitation, the activities of sponsoring, organizing, and managing a closed-end investment company, such as a hedge fund, and furnishing general economic information and advice.<sup>38</sup> The Board of Governors also previously determined that providing administrative and other services to mutual funds could be provided in connection with acting as an investment or financial advisor as activities that were closely related to banking as described further below.

- ***Issuing or selling instruments representing interests in pools of bank-permissible assets***

Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly is a financial activity specifically enumerated in section 4(k).<sup>39</sup>

- ***Underwriting, dealing, and market making***

Underwriting, dealing in, or making a market in securities is a financial activity specifically enumerated in section 4(k) of the BHC Act,<sup>40</sup> which includes sponsoring and distributing all types of mutual funds and investment companies.<sup>41</sup>

- ***Merchant banking***

Section 4(k)(4)(H) of the BHC Act describes the financial activity of acquiring or controlling shares, assets or ownership interests, including debt or equity securities, in a company engaged in any activity not authorized under section 4 of the BHC Act “as part of a bona fide underwriting or merchant or investment banking activity, including investment activities engaged in for the purpose of appreciation and ultimate resale or

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<sup>38</sup> See 12 CFR 225.28(b)(6) and 225.125.

<sup>39</sup> 12 U.S.C. 1843(k)(4)(D).

<sup>40</sup> 12 U.S.C. 1843(k)(4)(E).

<sup>41</sup> See H.R. Rep. No. 106-434 at 153 (1999) (Conf. Rep.)

disposition of the investment”<sup>42</sup>(“merchant banking”). Section 4(k)(4)(H) imposes several requirements on financial holding companies seeking to engage in merchant banking activities. In particular, (i) the shares may not be acquired or held by a depository institution; (ii) the shares must be acquired and held by a securities affiliate or an affiliate thereof, or in the case of a financial holding company that has an insurance company affiliate, by an affiliate that provides investment advice to an insurance company and is registered pursuant to the Investment Advisers Act of 1940, or an affiliate thereof; (iii) the shares must be held as part of a bona fide underwriting or merchant or investment banking activity, including investment activities engaged in for the purpose of appreciation and ultimate resale or disposition of the investment; (iv) the shares are held for a period of time to enable the sale or disposition on a reasonable basis consistent with the financial viability of the company’s underwriting, merchant, or investment banking activities; and (v) during the period the shares are held, the bank holding company does not routinely manage or operate the company except as may be necessary to obtain a reasonable return on investment upon resale or disposition.<sup>43</sup>

The Board of Governors determined in its final rule that the condition in section 4(k)(4)(H) requiring that the shares only be held for a period of time to enable their sale or disposition on a reasonable basis consistent with the financial viability of the company’s merchant banking activities is an essential element of a bona fide merchant banking activity. Thus, this condition is also reflected in this final rule. Bona fide merchant banking activities involve investing with the intent to sell the investment at

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<sup>42</sup> 12 U.S.C. 1843(k)(4)(H).

<sup>43</sup> See id.

some later point in time at which a profit is expected to be realized. For example, companies such as hedge funds, mutual funds, and private equity firms<sup>44</sup> that are engaged in bona fide merchant banking activities typically make investments in companies that they believe will increase in value over time and that can be resold at a profit. Hedge funds, mutual funds, and private equity funds invest with the expectation of selling those instruments at a future date in order to realize profits consistent with a particular investment strategy rather than for the purpose of owning and operating the business.

The Board of Governors and the Secretary of the Treasury jointly issued regulations adopting holding periods for merchant banking investments by financial holding companies pursuant to section 4(k)(4)(H).<sup>45</sup> Specific time periods are not set forth in section 4(k). As such, the Board of Governors did not include a condition on holding periods in the definition of merchant banking in the Board of Governors' final rule for purposes of Title I. Similarly, the FDIC has not included such a condition in this final rule. However, the Board of Governors noted in the preamble to the Board of Governors' final rule that the time periods adopted by the Board of Governors and the Secretary are instructive in determining whether a nonbank company is engaged in bona fide merchant banking activities under Title I. Thus, for purposes of determining whether a nonbank company is predominantly engaged in financial activities under Title I, nonbank companies that acquire and hold shares for the period permitted for financial

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<sup>44</sup> See H.R. Rep. No. 106-434 at 154 (1999) (Conf. Rep.) (describing the merchant banking authority under section 4(k)(4)(H) as authorizing a financial holding company ("FHC") to acquire an ownership interest "in an entity engaged in any kind of trade or business whatsoever . . . whether acting as principal, on behalf of one or more entities (e.g., as adviser to a fund, regardless of whether the FHC is also an investor in the fund), including entities that the FHC controls (other than a depository institution or a subsidiary of a depository institution), or otherwise.").

<sup>45</sup> See 12 CFR 225.172 and 12 CFR 1500.3, respectively.

holding companies under the Board of Governors' regulations are presumed to hold the shares for the purpose of appreciation and ultimate resale or disposition in accordance with the condition in section 4(k)(4)(H). Similarly, for purposes of this final rule under Title II, shares held for the period permitted for financial holding companies under the Board of Governors' regulations generally will be treated as held for the purpose of appreciation and ultimate resale or disposition in accordance with the condition in section 4(K)(4)(H). This approach will help companies determine whether they are predominantly engaged in financial activities.

The Board of Governors recognized in its final rule that some investment vehicles may hold shares for longer periods as part of a bona fide merchant banking activity consistent with the vehicle's investment strategy. For this reason, the Board of Governors' final rule permitted the Financial Stability Oversight Council, with respect to the definition of a "nonbank financial company" for purposes of Title I, or the Board of Governors, with respect to the definition of a "significant nonbank financial company", to determine, on a case-by-case basis, whether a company that acquires and holds shares for a period of time greater than the period permissible for a financial holding company is engaged in bona fide merchant banking activities for purposes of determining whether the company is predominantly engaged in financial activities under Title I. Similarly, this final rule permits the recommending agencies and the Secretary to determine on a case-by-case basis, whether a company that acquires and holds shares for a period of time greater than the period permissible for a financial holding company is engaged in bona fide merchant banking and, therefore, a financial activity for purpose of Title II.



The Board of Governors' final rule clarifies that the prohibition in section 4(k)(4)(H) on routinely managing a portfolio company, other than for purposes of recognizing a reasonable return on resale or disposition, is an essential element of bona fide merchant banking activities. As previously discussed, companies engaging in these activities purchase shares of portfolio companies to recognize an ultimate profit, rather than to engage in the underlying activity in which the portfolio company engages as its primary business activity. Routinely managing the companies, other than for the goal of recognizing a reasonable return, may indicate a strategic investment in the operations of another firm. This prohibition is included in the final rule for purposes of Title II.

Section 4(k) does not define the statutory prohibition of routinely managing a portfolio company. The regulations issued by the Board of Governors and the Secretary governing the merchant banking activities of financial holding companies provide guidance on the statutory prohibition of routinely managing a portfolio company in connection with a bona fide merchant banking activity. The Board of Governors determined in its final rule that such regulations are instructive in determining whether a nonbank company is engaged in bona fide merchant banking activities for purposes of Title I. The FDIC has determined to adopt a similar approach for purposes of this final rule. Therefore, for purposes of determining whether a company is engaged in a bona fide merchant banking activity under Title II, companies that comply with the Board of Governors' guidance regarding the limitations on managing or operating a portfolio company generally will be treated as engaged in a bona fide merchant banking activity.

This approach will reduce burden on companies attempting to determine whether they, or certain of their counterparties,<sup>46</sup> are predominantly engaged in financial activities.

By contrast, the Board of Governors' final rule concluded that the condition in section 4(k)(4)(H) requiring a financial holding company engaging in merchant banking activities to have a securities affiliate is not an essential element of bona fide merchant banking activities for determining whether these activities are financial activities.<sup>47</sup> This is evidenced by the fact that section 4(k) does not require that the securities affiliate participate in or play a role with respect to these activities. The Board of Governors determined in the Board of Governors' final rule that this condition was designed to ensure that only those financial holding companies with experience engaging in investment, securities, or advisory activities conducted merchant banking activities. Accordingly, this condition is not reflected in this final rule.

Similarly, the Board of Governors concluded that the condition in section 4(k)(4)(H) requiring that shares acquired as part of a bona fide merchant banking activity not be acquired or held by a depository institution is not an essential element of such activities. This restriction was imposed because banks are restricted from investing in certain types of companies by statute and regulation, and in particular, national banks were prohibited by the GLB Act from engaging in merchant banking activities through a

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<sup>46</sup> See id.

<sup>47</sup> The legislative history related to Congress's authorization of "underwriting, merchant, and investment banking activities" distinguishes between the activities themselves and certain conditions imposed on the conduct of these activities by a financial holding company that do not define the activities, such as the requirement that a financial holding company have a securities affiliate. See Conf. Rep. 106-434, 154 (November 2, 1999). ("The authorization of merchant banking activities as provided in new section 4(k)(4)(H) of the BHCA is designed to recognize the essential role that these activities play in modern finance and permits an FHC that has a securities affiliate or an affiliate of an insurance company engaged in underwriting life, accident and health, or property and casualty insurance, or providing and issuing annuities, to conduct such activities.").

financial subsidiary unless certain findings were made by the Secretary and the Board of Governors.<sup>48</sup> The Board of Governors concluded that the restriction on acquiring or holding investments through a depository institution does not define the activity of merchant banking but rather imposes conditions on holding the investment through one type of corporate affiliate. The condition does not define the activity itself, as financial holding companies, which have bank affiliates, engage in these activities on a regular basis. Accordingly, the condition is not included in this final rule.

Finally, section 4(k)(4)(H) provides that shares acquired in connection with a bona fide merchant banking activity must be those of a company engaged in an activity not authorized under section 4 of the BHC Act. This provision provided new authority for bank holding companies that qualify as financial holding companies to engage in merchant banking activities with regard to nonbanking firms; bank holding companies were already authorized under other provisions of section 4 of the BHC Act to invest in firms engaged in financial activities.<sup>49</sup> For this reason, the Board of Governors retained this reference to an “activity not authorized under section 4 of the BHC Act” in the description of bona fide merchant banking activities in the Board of Governors’ final rule. An investment in a company engaged in activities otherwise permissible under section 4 would otherwise be treated as a financial activity under section 4(k)(1) or other provisions of section 4(k). Thus, shares acquired in all types of firms in connection with

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<sup>48</sup> See, e.g., 12 U.S.C. 24, (Seventh); 12 U.S.C. 24, (Eleventh); 12 CFR 1.

<sup>49</sup> See 65 FR 16460, 16463-16464 (March 28, 2000), in which the Board of Governors noted that the provision in section 4(k)(4)(H) that authorizes a financial holding company to invest in any company engaged in any activity not authorized pursuant to section 4 of the BHC Act “appears to have been included in recognition of the fact that other provisions of the BHC Act permit a financial holding company to make investments in companies that conduct financial activities without resorting to merchant banking authority.”

a bona fide merchant banking activity are effectively included by section 4(k) within the list of permissible financial activities. Consequently, the requirement that shares acquired in connection with a bona fide underwriting, merchant, or investment banking activity must be those of a company engaged in an activity not authorized under section 4 of the BHC Act is included in this final rule.

- ***Insurance Company Portfolio Investments***

Section 4(k)(4)(I) of the BHC Act authorizes companies engaged in certain types of insurance activities to make portfolio investments. In particular, financial holding companies are authorized to acquire assets or ownership interests, including debt or equity securities, of a company or other entity engaged in any activity not authorized by section 4(k) if: (i) the shares, assets, or ownership interests are not acquired or held by a depository institution or a subsidiary of a depository institution; (ii) such shares, assets, or ownership interests are acquired and held by an insurance company that is predominantly engaged in underwriting life, accident and health, or property and casualty insurance (other than credit-related insurance) or providing and issuing annuities; (iii) such shares, assets, or ownership interests represent an investment made in the ordinary course of business of such insurance company in accordance with relevant state law governing such investments; and (iv) during the period such shares, assets, or ownership interests are held, the bank holding company does not routinely manage or operate such company except as may be necessary or required to obtain a reasonable return on investment.<sup>50</sup>

The Board of Governors determined in its final rule that the conditions in section 4(k)(4)(I) requiring that the shares be acquired and held (i) by an insurance company

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<sup>50</sup> 12 U.S.C. 1843(k)(4)(I).

engaged in particular activities, and (ii) in the ordinary course of business of the acquiring insurance company in accordance with relevant state law governing such investments, are essential elements of this activity. Insurance company portfolio investments were authorized by Congress specifically to permit “an insurance company that is affiliated with a depository institution to continue to directly or indirectly acquire or control any kind of ownership interest in any company,” in recognition of the fact “that as part of the ordinary course of business, insurance companies frequently invest funds received from policyholders by acquiring most or all the shares of stock of a company that may not be engaged in a financial activity.”<sup>51</sup> Thus, these conditions are reflected in the final rule. In contrast to merchant banking activities described in section 4(k)(4)(H), which requires a financial holding company engaging in such activities to have a securities affiliate, but does not require that the securities affiliate play a role in the activities, section 4(k)(4)(I) requires that the investment activities authorized thereunder be conducted by or through an insurance company.

The Board of Governors determined in its final rule that the prohibition in section 4(k)(4)(I) on routinely managing a portfolio company, other than for purposes of recognizing a reasonable return on the investment, is an essential element of the investment activities conducted by insurance companies as well. Thus, this prohibition is reflected in this final rule for purposes of Title II. As noted previously, insurance companies typically invest policyholder funds in other companies in the ordinary course of business pursuant to state insurance laws. Routinely managing the companies, other

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<sup>51</sup> See H.R. Rep. No. 106-434 at 154 (1999) (Conf. Rep.) (further describing section 4(k)(4)(I) as recognizing that “these investments are made in the ordinary course of business pursuant to state insurance laws governing investments by insurance companies, and are subject to ongoing review and approval by the applicable state regulator.”

than for the purpose of recognizing a return on investment, may indicate a strategic investment in the operations of the other company.<sup>52</sup>

Section 4(k)(4)(I) requires that shares acquired pursuant to an insurance company's investment activities not be acquired or held by a depository institution. The Board of Governors' final rule does not identify this condition as an essential element of this activity, and, thus, it is not reflected in this final rule. The restriction on acquiring or holding investments through a depository institution does not define the investment activity described in section 4(k)(4)(I), but rather imposes conditions on holding the investment through one type of corporate affiliate. As discussed previously, section 4(k)(4)(I) requires that the investment activities authorized thereunder be conducted by or through an insurance company. In addition, as noted previously, banks are restricted from investing in certain types of companies by statute and regulation.<sup>53</sup> The Board of Governors' final rule clarifies that the condition does not define the activity itself, as insurance companies affiliated with depository institutions engage in these activities on a regular basis.<sup>54</sup> Accordingly, this condition is not included in this final rule for purposes of Title II.

Finally, as in section 4(k)(4)(H), section 4(k)(4)(I) provides that shares acquired by an insurance company in connection with its investment activities must be those of a

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<sup>52</sup> See *id.* at 155 (noting that “to the extent an FHC participates in the management or operation of a portfolio company, such participation would ordinarily be for the purpose of safeguarding the investment of the insurance company in accordance with applicable state insurance law. This is irrespective of any overlap between board members and officers of the FHC and the portfolio company.”)

<sup>53</sup> See, e.g., 12 U.S.C. 24, (Seventh); 12 U.S.C. 24, (Eleventh); 12 CFR 1.

<sup>54</sup> As discussed above, section 4(k)(4)(I) was intended to permit “an insurance company that is affiliated with a depository institution to continue to directly or indirectly acquire or control any kind of ownership interest in any company if certain requirements are met.” See H.R. Rep. No. 106-434 at 154 (1999) (Conf. Rep.).

company engaged in an activity not authorized under section 4 of the BHC Act. An investment in a company engaged in activities otherwise permissible under section 4 would be treated as a financial activity under section 4(k)(1) or other provisions of section 4(k). Thus, investments by insurance companies in all types of firms are effectively included by section 4(k) within the list of permissible financial activities. Like the Board of Governors' final rule, this final rule also includes this condition.

- ***Lending, exchanging, transferring, investing for others, safeguarding financial assets other than money or securities, and other activities***

The activities of lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities; providing any device or other instrumentality for transferring money or other financial assets; and arranging, effecting, or facilitating financial transactions for the account of third parties are financial activities specifically enumerated in section 4(k)(5) of the BHC Act.<sup>55</sup>

## **2. Financial activities that are closely related to banking**

Section 4(k) provides that “any activity that the Board has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto” is a financial activity.<sup>56</sup> These activities, as described in more detail below, are also included in the definition of “financial activities” for purposes of Title II.

### ***Extending credit and servicing loans***

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<sup>55</sup> 12 U.S.C. 1843(k)(5). The BHC Act requires the Board of Governors to define the extent to which these activities are financial in nature or incidental thereto. The Board of Governors and the Secretary issued a joint interim rule authorizing such activities as permissible for financial holding companies. See 66 FR 257 (January 3, 2001).

<sup>56</sup> 12 U.S.C. 1843(k)(4)(F).

Making, acquiring, brokering, or servicing loans or other extensions of credit (including factoring, issuing letters of credit and accepting drafts) for the company's account or for the account of others were authorized by the Board of Governors as activities that are closely related to banking.<sup>57</sup>

- *Activities related to extending credit*

Activities usual in connection with making, acquiring, brokering, or servicing loans or other extensions of credit were authorized by the Board of Governors as activities that are closely related to banking.<sup>58</sup> These activities include performing appraisals of real estate and personal property (including securities), acting as an intermediary for commercial or industrial real estate financing, providing check guarantee, collection agency, and credit bureau services, engaging in asset management, servicing, and collection activities, acquiring debt in default, and providing real estate settlement services.<sup>59</sup>

The Board of Governors' regulations impose certain conditions on the conduct of these activities that are not relevant for determining whether these activities are considered financial for purposes of determining whether a firm is predominantly engaged in financial activities under Title II. For instance, under the Board of Governors' regulations, a bank holding company that is arranging financing for commercial or industrial income-producing real estate may not have an interest in, participate in managing or developing, or promote or sponsor the development of a

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<sup>57</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(1). See 62 FR 9290, 9305 (February 28, 1997), in which the Board of Governors noted that "[l]ending activities are already broadly defined and contain no restrictions."

<sup>58</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(2).

<sup>59</sup> Id.



property for which it is arranging financing, or engage in property management or real estate brokerage.<sup>60</sup> These conditions were imposed to clarify that real property management and real estate brokerage activities—which were not at the time found to be financial activities—are not indirectly authorized as permissible for bank holding companies through the activity of real estate financing.<sup>61</sup> As such, the Board of Governors’ final rule reflects the activity of arranging commercial real estate financing without reference to the independent activities of owning, managing, developing, or promoting or sponsoring development of real estate.<sup>62</sup> Accordingly, this final rule takes the same approach. While neither real estate brokerage nor real estate management are financial activities under section 4(k), a company may engage in these activities and still be predominantly engaged in the financial activity of arranging commercial real estate financing. Under the final rule, only revenues associated with this latter activity are considered financial for purposes of determining whether a firm is predominantly engaged in financial activities.

Acquiring debt in default also is a financial activity for purposes of determining whether a firm is predominantly engaged in financial activities under Title II as it is an activity that is usual in connection with making, acquiring, brokering, or servicing loans

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<sup>60</sup>12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(2)(ii).

<sup>61</sup> The Board of Governors first approved the application of a bank holding company to engage in real estate equity financing in 1982. In approving this activity, the Board of Governors noted that it had imposed conditions, including that the bank holding company not have an interest in, participate in managing or developing, or promote or sponsor the development of a property for which it is arranging financing, “to confine the activity . . . to equity financing and to prevent [the bank holding company] from engaging in real estate development . . .” See BankAmerica Corporation, 68 Federal Reserve Bulletin 647 (1982). The activity of arranging commercial real estate equity financing was added to the Board of Governors’ Regulation Y in 1984 and incorporated the limitations that the Board of Governors had placed on the activity in the 1982 order. See 70 Federal Reserve Bulletin 121, 137 (1984).

<sup>62</sup> Neither real estate brokerage nor real estate management is an activity that is financial in nature. See 12 U.S.C. 1843 note; Pub. Law 111-8, sec. 624 (Mar. 11, 2009).

or other extensions of credit.<sup>63</sup> Under the Board of Governors' regulations, a bank holding company that acquires debt in default must divest assets securing the debt that are impermissible for bank holding companies to hold within a certain time period, stand only in the position of a creditor, not purchase equity of obligors of debt in default, and not acquire debt in default secured by shares of a bank or bank holding company. These conditions are intended to prevent bank holding companies from circumventing the BHC Act and other provisions of law. For instance, the condition requiring a bank holding company to divest impermissible assets within a certain timeframe was intended to distinguish between a bank holding company's acquisition of debt in default and its retention of impermissible collateral securing the debt.<sup>64</sup> The conditions requiring the bank holding company to stand only in the position of a creditor and not purchase equity of obligors of debt in default are intended to prevent a bank holding company from acquiring assets in connection with a debt previously contracted the ownership of which is prohibited by the BHC Act or other provisions of law. The Board of Governors determined in the Board of Governors' final rule that these conditions are not related to defining the financial nature of the activity of acquiring debt in default. The condition requiring that the debt not be secured by shares of a bank or bank holding company was imposed to prevent the bank holding company from circumventing the BHC Act's requirement that a bank holding company obtain approval from the Board of Governors before acquiring control of another bank or bank holding company.<sup>65</sup> For these reasons, these conditions are not relevant for determining whether the activity is financial for

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<sup>63</sup> 12 CFR 225.28(b)(2)(vii).

<sup>64</sup> See 62 FR 9290, 9305 (February 28, 1997).

<sup>65</sup> Id.

purposes of Title I. Accordingly, the final rule provides that the activity of acquiring debt that is in default at the time of acquisition is a financial activity for purposes of determining whether a company is predominantly engaged in financial activities under Title II without reference to these conditions.

- ***Leasing***

Leasing personal or real property, and acting as an agent, broker, or adviser for leasing personal or real property were determined to be closely related to banking by the Board of Governors.<sup>66</sup> Under the Board of Governors' regulations, permissible leasing must involve a lease that is on a nonoperating basis with an initial term of at least 90 days. In addition, leasing involving real property must have the effect of yielding a return that will compensate the lessor for not less than the lessor's full investment plus the estimated cost of financing the property over the term of the lease, and the property must have an estimated residual value that is no more than 25 percent of the acquisition cost of the property. The Board of Governors determined in the Board of Governors' final rule that these conditions serve to distinguish between the financial activity of leasing and the nonfinancial activities of real or personal property rental and real estate management.<sup>67</sup> As such, the final rule reflects these conditions in defining the activities of leasing and acting as an agent, broker, or adviser for personal or real property.

- ***Operating nonbank depository institutions***

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<sup>66</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(3).

<sup>67</sup> See 62 FR 9290, 9306 (February 28, 1997) ("These requirements were developed in the course of litigation regarding the leasing activities of national banks, and were relied on by the courts in distinguishing bank leasing activities from general property rental and real estate development businesses. The requirement that a lease be nonoperating is also a statutory requirement limiting the high residual value leasing activities of national banks.")

The activity of owning, controlling, and operating depository institutions, including industrial banks, Morris Plan banks, industrial loan companies and savings associations that do not qualify as “banks” for purposes of the BHC Act was determined to be closely related to banking by the Board of Governors.<sup>68</sup> While the Board of Governors’ regulations require that a thrift owned, controlled, or operated by a bank holding company be engaged only in deposit-taking activities and activities permissible for bank holding companies, the final rule does not include these conditions because they are inconsistent with section 201(b) of the Dodd-Frank Act, which provides that all revenues from the ownership of a depository institution shall be considered to be financial for purpose of Title II.

- ***Trust company functions***

The activities performed by a trust company (including activities of a fiduciary, agency, or custodial nature) that is not a bank for purposes of section 2(c) of the BHC Act were determined to be closely related to banking by the Board of Governors.<sup>69</sup>

- ***Financial and investment advisory activities***

Acting as an investment or financial advisor to any person was determined to be closely related to banking by the Board of Governors.<sup>70</sup> The activity includes, without limitation, serving as a registered investment adviser to a registered investment company, including sponsoring, organizing, and managing a closed-end investment company; furnishing general economic information and advice, general economic statistical forecasting services, and industry studies; providing advice in connection with mergers,

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<sup>68</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(4).

<sup>69</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(5).

<sup>70</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(6).

acquisitions, divestitures, investments, joint ventures, leveraged buyouts, recapitalizations, capital structurings, financing transactions and similar transactions; and conducting financial feasibility studies; providing information, statistical forecasting, and advice with respect to any transaction in foreign exchange, swaps, and similar transactions, commodities, and any forward contract, option, future, option on a future, and similar instruments; providing educational courses and instructional materials to consumers on individual financial management matters; and providing tax-planning and tax-preparation services to any person.<sup>71</sup>

- ***Agency transactional services for customer investments***

Providing agency transactional services, including providing securities brokerage services, acting as a riskless principal, providing private placement services, and acting as a futures commission merchant were determined to be closely related to banking by the Board of Governors.<sup>72</sup>

The Board of Governors' Regulation Y imposes conditions on the manner in which a bank holding company may conduct securities brokerage services, act as riskless principal, provide private placement services, and act as a futures commission merchant. For instance, bank holding companies providing securities brokerage services under this authority are limited to buying and selling securities solely as agent for the account of customers and may not conduct securities underwriting or dealing activities. Bank holding companies providing private placement services under this authority may not purchase or repurchase for their own account the securities being placed or hold in

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<sup>71</sup> Id.

<sup>72</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(7).

inventory unsold portions of issues of those securities. Bank holding companies acting as riskless principal under this authority are subject to conditions with respect to bank-ineligible securities.

Each of these conditions was intended to prevent a bank holding company from engaging in securities underwriting or dealing activities in connection with the activities of securities brokerage, private placement, or riskless principal, which were impermissible for bank holding companies under the Glass-Steagall Act at the time the activities were authorized.<sup>73</sup> The fact that a firm may retain some portion of shares in connection with, for example, private placement activities, does not affect or negate the financial nature of private placement activities. Moreover, as described elsewhere, securities underwriting and dealing activities were subsequently determined by statute to be financial activities. Thus, the final rule adopts the Board of Governors' interpretation, as expressed in the Board of Governors' final rule, that the following activities are financial without the non-definitional conditions:

- Providing securities brokerage services (including securities clearing and/or securities execution services on an exchange), whether alone or in combination with investment advisory services, and incidental activities (including related securities credit activities and custodial services).
- Buying and selling in the secondary market all types of securities on the order of customers as a "riskless principal" in a transaction in which the company purchases (or sells) the security for its own account to offset a contemporaneous sale to (or purchase from) the customer.
- Acting as agent for the private placement of securities in accordance with the requirements of the Securities Act of 1933 (1933 Act) and the rules of the Securities and Exchange Commission.

Under the Board of Governors' regulations, a bank holding company acting as a futures commission merchant must conduct the activity through a separately incorporated

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<sup>73</sup> See 62 FR 9290, 9307-9308 (February 28, 1997).

subsidiary, the contract must be traded on an exchange, and the parent bank holding company may not guarantee that subsidiary's liabilities. The Board of Governors' final rule does not reflect these conditions, as they were imposed for the prudential purpose of limiting the transmission of risk from these activities to an insured depository affiliate or the parent bank holding company.<sup>74</sup> Similarly, this final rule does not contain these conditions for purposes of Title II.

The Board of Governors' regulations also contain a broad provision authorizing a bank holding company to provide "transactional services for customers involving any derivative or foreign exchange transaction that a bank holding company is permitted to conduct for its own account."<sup>75</sup> Specifically, the Board of Governors' Regulation Y describes the activity as "[p]roviding to customers as agent transactional services with respect to swaps and similar transactions, any transaction described in paragraph (b)(8) of this section, any transaction that is permissible for a state member bank, and any other transaction involving a forward contract, option, futures, option on a futures or similar contract (whether traded on an exchange or not) relating to a commodity that is traded on an exchange."<sup>76</sup> In the FDIC's second NPR, the FDIC proposed removing the

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<sup>74</sup> *Id.* at 9309. ("The Board has determined that a . . . restriction that prohibits the parent bank holding company from guaranteeing or otherwise becoming liable for non-proprietary trades conducted by or through its FCM subsidiary . . . effectively addresses the Board's concern about a parent bank holding company's exposure to an exchange's or clearinghouse's loss sharing rules . . . [by protecting] the parent bank holding company from potential exposure from customer trades and open-ended contingent liability under loss sharing rules . . .").

<sup>75</sup> *Id.* at 9310.

<sup>76</sup> 12 CFR 225.28(b)(7)(v). The Board of Governors' 1997 rulemaking describes this financial activity as permitting a bank holding company to "...act as a broker with respect to forward contracts based on a financial or nonfinancial commodity that also serves as the basis for an exchange-traded futures contract. This permits a bank holding company to act as agent in a forward contract that involves the same commodities and assessment of risk that underlay the permissible FCM activities of bank holding companies without extending this authority to forward contracts for the delayed sale of commercial

requirement that agent transactional services on certain commodity derivatives transactions be provided only with respect to a commodity that is traded on an exchange (regardless of whether the contract being traded is traded on an exchange) because the limitation was imposed for safety and soundness reasons. In light of comments received, the Board of Governors determined in its final rule that this condition, while serving a prudential role, also is part of the definition of the authorized activity because it prevents a bank holding company from engaging in the forward sale of commercial products. Because the condition distinguishes the financial activity of engaging in derivatives contracts from the commercial sale of assets, the final rule includes this condition.

- ***Investment transactions as principal***

Engaging in investment transactions as principal, including underwriting and dealing in government obligations and money market instruments, investing and trading as principal in foreign exchange and derivatives, and buying and selling bullion were determined to be closely related to banking by the Board of Governors.<sup>77</sup> Under the Board of Governors' regulations, bank holding companies engaged in underwriting and dealing in government obligations and money market instruments are subject to the same limitations as would be applicable if the activity were performed by member banks.<sup>78</sup> The Board of Governors' final rule does not reflect this limitation because the Board of Governors determined that this condition was intended to prevent circumvention of the Glass-Steagall Act. It does not define the activity of engaging in investment transactions

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products (such as automobiles, consumer products, etc.) or real estate.” See 62 FR 9290, 9311 (February 28, 1997).

<sup>77</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(8).

<sup>78</sup> 12 CFR 225.28(b)(8)(i).



as principal and is, therefore, not relevant for determining whether the activity of underwriting and dealing in government obligations and money market instruments is financial for purposes of determining whether a firm is predominantly engaged in financial activities.<sup>79</sup>

Under the Board of Governors' regulations, engaging in derivatives transactions is a financial activity provided that the derivative contract is not a bank-ineligible security, and either the asset underlying the contract is a bank permissible asset or the contract contains conditions designed to limit the potential that physical settlement would occur.<sup>80</sup>

In the FDIC's second NPR, the FDIC proposed to remove these conditions in defining derivatives activities that are financial activities. The Board of Governors received comments in response to the Board of Governors' second NPR that expressed the view that the conditions requiring cash settlement were necessary to distinguish between commercial activities involving physically-settled derivatives contracts and the types of financial derivative activities conducted by financial companies. The Board of Governors noted in its final rule that these conditions were originally imposed to reduce the potential that bank holding companies would become involved in, and bear the risks of, physical possession, transport, storage, and delivery of commodities and to ensure that the commodity derivatives business of a bank holding company is largely limited to acting as a financial intermediary in the facilitation of transactions for customers who use or produce commodities or are otherwise exposed to commodity price risk as part of their

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<sup>79</sup> 62 FR 9290, 9311 (February 28, 1997).

<sup>80</sup> 12 CFR 225.28(b)(8)(ii)(B).

regular business.<sup>81</sup> In certain instances, the Board of Governors has determined that engaging in physically-settling commodities, physical commodity trading, energy tolling, and energy management services, are activities that are complementary to the financial activity of engaging as principal in commodity derivatives transactions.<sup>82</sup> Under section 4(k), complementary activities are those that, although not necessarily financial in nature, are so meaningfully connected to financial activities that they complement those financial activities.

The Board of Governors determined in its final rule that these conditions, while serving an important prudential role, are also part of the definition of the authorized activity because they distinguish these derivatives activities from similar derivatives activities that are not conducted as a financial intermediary. Thus, the final rule includes, as a financial activity for purposes of Title II, engaging as principal in forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on any rate, price, financial asset (including gold, silver, platinum, palladium, copper, or any other metal), nonfinancial asset, or group of assets, other than a bank-ineligible security<sup>83</sup> if: (i) a state member bank is authorized to invest

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<sup>81</sup> See 68 FR 39807, 39808 (July 3, 2003).

<sup>82</sup> See Board of Governors letters regarding Bank of America Corporation (April 24, 2007), Credit Suisse Group (March 27, 2007), Fortis S.A./N.V. (September 29, 2006), and Wachovia Corporation (April 13, 2006); and Board orders regarding Royal Bank of Scotland Group plc, 94 Federal Reserve Bulletin C60 (2008), Societe Generale, 92 Federal Reserve Bulletin C113 (2006), Deutsche Bank AG, 91 Federal Reserve Bulletin C54 (2005), JPMorgan Chase & Co., 91 Federal Reserve Bulletin C57 (2005); Barclays Bank PLC, 90 Federal Reserve Bulletin 511 (2004), UBS AG, 90 Federal Reserve Bulletin 215 (2004), and Citigroup Inc., 89 Federal Reserve Bulletin 508 (2003).

<sup>83</sup> The Board of Governors' Regulation Y provides that a bank-ineligible security is any security that a state member bank is not permitted to underwrite or deal in under 12 U.S.C. 24 and 335.

in the asset underlying the contract;<sup>84</sup> (ii) the contract requires cash settlement; (iii) the contract allows for assignment, termination, or offset prior to delivery or expiration, and the company makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract, or receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset; or (iv) the contract does not allow for assignment, termination, or offset prior to delivery or expiration and is based on an asset for which futures contracts or options on futures contracts have been approved for trading on a U.S. contract market by the Commodity Futures Trading Commission, and the company makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract, or receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset.

Similarly, engaging as principal in forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on an index of a rate, a price, or the value of any financial asset, nonfinancial asset, or group of assets, is a financial activity under the Board of Governor's final rule only if the contract requires cash settlement. The final rule adopts this approach.

Additionally, investing and trading in foreign exchange is a financial activity under the Board of Governors' regulations and is thus included in both the Board of Governors' final rule and this final rule

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<sup>84</sup> State member banks may own, for example, investment grade corporate debt securities, U.S. government and municipal securities, foreign exchange, and certain precious metals. See 68 FR 39807, 39808, note 2 (July 3, 2003).

- ***Management consulting and counseling activities***

The Board of Governors has authorized management consulting as a permissible activity under several different authorities, each of which are encompassed within the cross-references contained in section 4(k). Providing management consulting advice on any matter to unaffiliated depository institutions and on any financial, economic, accounting, or audit matter to any other company (“financial management consulting services”) was determined to be closely related to banking by the Board of Governors.<sup>85</sup> Under the Board of Governors’ regulations, bank holding companies that engage in financial management consulting services also are permitted to provide management consulting services generally to any company other than an unaffiliated depository institution, on any non-financial matter (“non-financial management consulting services”), provided at least 70 percent of the bank holding company’s total annual revenue derived from all management consulting services is derived from financial management consulting services. The revenue limitation on providing non-financial management consulting services was designed to limit the involvement of bank holding companies in the provision of management consulting services on non-financial matters to nondepository institutions. The Board of Governors determined in its final rule that the limitations on the authority of bank holding companies to provide non-financial

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<sup>85</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(9)(i). The Board of Governors’ regulations provide that in conducting management consulting advice, bank holding companies are not authorized to perform tasks or operations or provide services to client institutions either on a daily or continuing basis, except as necessary to instruct the client institution on how to perform such services for itself. This restriction was designed to limit a bank holding company’s activities to providing advice rather than other services that may involve impermissible activities for bank holding companies. For purposes of Title II, revenues derived from providing management consulting services to a depository institution and any consulting on financial, economic, accounting, or audit matters to any company, will be considered financial regardless of other services the firm might provide. See 12 CFR 225.28(b)(9)(i), note 11.

management consulting services does not change the nature of the permissible financial management consulting services done within those limits. Therefore, for purposes of the final rule, revenues derived from any management consulting services to a depository institution and any consulting on financial, economic, accounting, or audit matters to any company, will be considered financial activities. In addition, because a bank holding company may derive up to 30 percent of its total annual revenue from non-financial management consulting services and still be considered to be engaged in financial management consulting activities under the Board of Governors' regulations, for purposes of the final rule, up to 30 percent of a nonbank company's revenues related to non-financial management consulting services will be included in the company's financial revenues.

The Board of Governors' regulations also prohibit a bank holding company providing financial management consulting services from owning or controlling more than 5 percent of the voting securities of a client institution or from having a management interlock.<sup>86</sup> These conditions were intended to ensure that a bank holding company does not effectively exercise control over a client company with which it has a management consulting contract, thereby circumventing the prohibitions and notice requirements applicable to bank holding companies seeking to acquire a controlling interest in a company engaged in nonbanking activities, and to prevent conflicts of interest.<sup>87</sup> The Board of Governors concluded in its final rule that these conditions also serve a definitional role to distinguish management consulting from the actual conduct of the

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<sup>86</sup> See *id.* See also 62 FR 9290, 9304, 9312 (February 28, 1997).

<sup>87</sup> See 62 FR 9290, 9304, 9312 (February 28, 1997).

commercial activity in which a client firm is engaged. These conditions are also included in this final rule.

The authorization for these activities overlaps with, and is largely subsumed under, the broader authority to engage in management consulting services that was determined to be usual in connection with banking abroad, described below. Therefore, a company that engages in management consulting activities in a manner that does not comply with the conditions described above will be considered to be engaged in a financial activity if its management consulting activities are captured by the broader authority.

Providing employee benefits consulting services to employee benefit, compensation and insurance plans, including designing plans, assisting in the implementation of plans, providing administrative services to plans, and developing employee communication programs for plans was determined to be closely related to banking by the Board of Governors.<sup>88</sup> Providing career counseling services also was determined to be closely related to banking by the Board of Governors,<sup>89</sup> subject to the condition that the services must be provided to a financial organization and individuals currently employed by, or recently displaced from, a financial organization; to individuals who are seeking employment at a financial organization, or to individuals currently employed in or who are seeking positions in the finance, accounting, and audit departments of any company. The Board of Governors determined in the Board of

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<sup>88</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(9)(ii).

<sup>89</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(9)(iii).

Governors' final rule that these conditions are essential to this activity's being considered financial, and thus, this activity is included in the final rule with these conditions.

- ***Courier services and printing and selling MICR-encoded items***

The activity of providing courier services for: (i) checks, commercial papers, documents, and written instruments (excluding currency or bearer-type negotiable instruments) that are exchanged among banks and financial institutions, and (ii) audit and accounting media of a banking or financial nature and other business records and documents used in processing such media was determined to be closely related to banking by the Board of Governors.<sup>90</sup>

The activity of printing and selling checks and related documents, including corporate image checks, cash tickets, voucher checks, deposit slips, savings withdrawal packages, and other forms that require Magnetic Ink Character Recognition encoding also was determined to be closely related to banking by the Board of Governors.<sup>91</sup>

- ***Insurance agency and underwriting***

Certain insurance activities, including activities related to the provision of credit insurance and insurance in small towns were determined to be closely related to banking by the Board of Governors.<sup>92</sup> Under the Board of Governors' regulations, bank holding companies may engage in these activities, subject to various conditions and limitations. The Board of Governors' final rule included these conditions and limitations, which are also reflected in this final rule. However, the authorization for these activities overlaps with, and is largely subsumed under, the general authority to engage in insurance

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<sup>90</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(10)(i).

<sup>91</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(10)(ii).

<sup>92</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(11).

underwriting and insurance agency activities discussed above. Therefore, a company that engages in insurance activities in a manner that does not comply with the conditions described above will be considered to be engaged in a financial activity if its insurance activities are captured by the general authority.

- ***Community development activities***

The activities of making debt and equity investments in corporations or projects that are designed primarily to promote community welfare, and providing advisory and related services for such programs was determined to be closely related to banking by the Board of Governors.<sup>93</sup>

- ***Money orders, savings bonds, and traveler's checks***

Issuing and selling money orders and similar consumer-type payment instruments, selling U.S. savings bonds, and issuing traveler's checks were determined to be closely related to banking by the Board of Governors.<sup>94</sup>

- ***Data processing***

Providing data processing services and related activities with respect to financial, banking, or economic data was determined to be closely related to banking by the Board of Governors.<sup>95</sup> Under the Board of Governors' regulations, a bank holding company's data processing activities must comply with the conditions that the hardware provided in connection with these services be offered only in conjunction with software related to the processing, storage, and transmission of financial, banking, or economic data, and that all

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<sup>93</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(12).

<sup>94</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(13).

<sup>95</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(14).



general purpose hardware provided with financial software not constitute more than 30 percent of the cost of any packaged offering.

The restrictions on providing hardware as part of providing financial data processing services were designed to limit the involvement of bank holding companies in the sale of data processing hardware, in particular, the sale of general purpose hardware. The Board of Governors determined in its final rule that the limitations on the authority of bank holding companies to provide hardware as part of financial data processing do not change the nature of the permissible financial data processing done within those limits. For purposes of applying this final rule, only that portion of a firm's data processing that involves providing financial data processing along with related hardware up to the limits imposed on bank holding companies would be considered financial activities for purposes of Title II. The provision of hardware or nonfinancial data processing beyond those limits would not disqualify the financial data processing revenues or assets, but also would not be considered financial activities.

- ***Mutual fund administrative services***

Providing administrative and other services to mutual funds was determined to be closely related to banking by the Board of Governors.<sup>96</sup>

- ***Owning shares of a securities exchange***

Owning shares of a securities exchange was determined to be closely related to banking by the Board of Governors.<sup>97</sup>

- ***Certification services***

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<sup>96</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(i).

<sup>97</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(ii).

Acting as a certification authority for digital signatures and authenticating the identity of persons conducting financial and nonfinancial transactions was determined to be closely related to banking by the Board of Governors.<sup>98</sup>

- ***Providing employment histories***

Providing employment histories to third parties for use in making credit decisions and to depository institutions and their affiliates for use in the ordinary course of business was determined to be closely related to banking by the Board of Governors.<sup>99</sup>

- ***Check-cashing and wire-transmission services***

Providing check-cashing and wire-transmission services was determined to be closely related to banking by the Board of Governors.<sup>100</sup>

- ***Postage, vehicle registration, public transportation services***

The activities of providing notary-public services, selling postage stamps and postage-paid envelopes, providing vehicle registration services, and selling public-transportation tickets and tokens, when offered in connection with banking services, were determined to be closely related to banking by the Board of Governors.<sup>101</sup>

- ***Real estate title abstracting***

Engaging in real estate title abstracting was determined to be closely related to banking by the Board of Governors.<sup>102</sup>

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<sup>98</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(iii).

<sup>99</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(iv).

<sup>100</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(v).

<sup>101</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(vi).

<sup>102</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(vii).

### **3. Financial activities that are usual in connection with banking or other financial operations abroad**

Section 4(k) defines as a financial activity “engaging, in the United States, in any activity that: (i) a bank holding company may engage in outside of the United States; and (ii) the Board has determined pursuant to section 4(c)(13) of the BHC Act to be usual in connection with the transaction of banking or other financial operations abroad.”<sup>103</sup> For purposes of this final rule, these activities are described below.

- ***Management consulting services***

As noted previously, the Board of Governors has authorized management consulting as a permissible activity under several different authorities, contained in the cross-references in section 4(k). In addition to finding that management consulting services are closely related to banking for purposes of section 4(c)(8) of the BHC Act, as described earlier, the Board of Governors also determined that providing management consulting services is usual in connection with the transaction of banking or other financial operations abroad under section 4(c)(13) of the BHC Act.<sup>104</sup> Under the Board of Governors’ regulations, a bank holding company may provide management consulting services, “including to any person with respect to nonfinancial matters, so long as the management consulting services are advisory and do not allow the financial holding company to control the person to which the services are provided.”<sup>105</sup>

In the FDIC’s second NPR, the FDIC proposed to define this financial activity without regard to the condition that the bank holding company not control a client firm

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<sup>103</sup> 12 U.S.C. 1843(k)(4)(G).

<sup>104</sup> 12 U.S.C. 1843(k)(4)(G); 12 CFR 225.86(b)(1).

<sup>105</sup> 12 CFR 225.86(b)(1).

because this condition was imposed to prevent bank holding companies from circumventing the prohibitions and approval requirements in the BHC Act and to prevent conflicts of interest, as described previously. However, the Board of Governors has determined in the Board of Governors' final rule that this condition also serves a definitional role to distinguish management consulting from the actual conduct of the activities in which a client firm is engaged, which may be commercial in nature. Therefore, the FDIC has restored this condition to the definition of management consulting activities that will be considered financial for purposes of Title II.

- ***Travel agency***

Operating a travel agency in connection with providing financial services was determined to be usual in connection with the transaction of banking or other financial operations abroad.<sup>106</sup> This activity could be conducted in connection with any of the financial activities listed in this final rule, such as, for example, engaging in credit card activities.<sup>107</sup>

- ***Mutual fund activities***

Organizing, sponsoring, and managing a mutual fund was determined to be usual in connection with the transaction of banking or other financial operations abroad.<sup>108</sup> Under the Board of Governor' regulations, bank holding companies are prohibited from exerting managerial control over the companies in which the mutual fund invests and must reduce their ownership to less than 25 percent of the equity of the mutual fund within one year of sponsoring the fund. The Board of Governors determined in the Board

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<sup>106</sup> 12 U.S.C. 1843(k)(4)(G); 12 CFR 225.86(b)(2).

<sup>107</sup> See 48 FR 56932, 56933 (December 27, 1983).

<sup>108</sup> 12 U.S.C. 1843(k)(4)(G); 12 CFR 225.86(b)(3).

of Governors' final rule that these conditions do not define the essential nature of organizing, sponsoring, or managing a mutual fund. Rather, they were imposed to prevent circumvention of the investment restrictions in the BHC Act.<sup>109</sup> Therefore, they are not reflected in this final rule.

- ***Commercial banking activities***

Engaging in commercial banking and other banking activities was determined to be usual in connection with the transaction of banking or other financial operations abroad.<sup>110</sup> Commercial banking activities include the ownership of a bank, as well as engaging in activities and making investments permissible for a bank.<sup>111</sup> The purchase of liquidity instruments, such as U.S. government securities, is an activity that is permissible for a bank. A nonbank company's purchase of liquidity instruments would be included in the company's financial revenues.

#### **4. Activities that are incidental to financial activities**

- ***Finder Activities***

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<sup>109</sup> Furthermore, the Board of Governors' regulations governing a financial holding company's merchant banking activities authorizes the financial holding company to own all of the voting shares of a fund, but no more than 25 percent of the equity of the fund, which demonstrates that section 4(k) authorizes financial holding companies to control funds. The limitation on a financial holding company's equity interest in a fund was a prudential limitation imposed to limit the potential losses to which the financial holding company may be exposed.

<sup>110</sup> 12 CFR 211.10(a)(1).

<sup>111</sup> The Board of Governors' regulations implementing section 4(k) do not include this activity because the regulations were intended to identify the activities that may be conducted using the post-transaction notice procedures. In the preamble to the final rule implementing section 4(k), the Board of Governors expressed the view that "the GLB Act did not authorize a financial holding company to conduct commercial and other banking activities in the United States by using the post-transaction notice procedure." 66 FR 400, 405 (January 3, 2001). The fact that post-transaction notice procedures are not available for commercial or other banking activities does not impact the conclusion that engaging in commercial and other banking activities is a financial activity for purposes of determining whether a firm is predominantly engaged in financial activities under Title II.

Acting as a finder in bringing together one or more buyers and sellers of any product or service for transactions that the parties themselves negotiate and consummate has been determined to be an activity that is incidental to a financial activity by the Board of Governors under section 4(k). Under regulations issued by the Board of Governors, acting as a finder includes providing any or all of the following services through any means: (a) identifying potential parties, making inquiries as to interest, introducing and referring potential parties to each other, and arranging contacts between and meetings of interested parties; (b) conveying between interested parties expressions of interest, bids, offers, orders and confirmations relating to a transaction; and (c) transmitting information concerning products and services to potential parties in connection with the activities listed in (a) and (b).<sup>112</sup>

The FDIC's second NPR proposed to define the finder activities discussed above as financial activities for purposes of Title II. Under the Board of Governors' Regulation Y, certain limitations are applicable to financial holding companies that engage in finder activities. These limitations include acting only as an intermediary between a buyer and a seller; and not binding any buyer or seller to the terms of a specific transaction or negotiating the terms of a specific transaction on behalf of a buyer or seller, except that (1) a finder may arrange for buyers to receive preferred terms from sellers so long as the terms are not negotiated as part of any individual transaction, are provided generally to customers or broad categories of customers, and are made available by the seller (and not by the company), and (2) a finder may establish rules of general applicability governing the use and operation of the finder service, including rules that govern the submission of

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<sup>112</sup> 12 CFR 255.86(a)(1).

bids and offers by buyers and sellers, the circumstances under which the finder service will match bids and offers, and the manner in which buyers and sellers may bind themselves to the terms of a specific transaction. The definition of “financial activities” in the FDIC’s second NPR included these conditions in the description of finder activities.

Additionally, The Board of Governors’ Regulation Y prohibits financial holding companies engaged in finder activities from (a) taking title to or acquiring or holding an ownership interest in any product or service offered or sold through the finder service; (b) providing distribution services for physical products or services offered or sold through the finder service; (c) owning or operating any real or personal property that is used for the purpose of manufacturing, storing, transporting, or assembling physical products offered or sold by third parties; (d) owning or operating any real or personal property that serves as a physical location for the physical purchase, sale or distribution of products or services offered or sold by third parties; or (e) engaging in any activity that would require the company to register or obtain a license as a real estate agent or broker under applicable law. Each of these conditions, with the exception of the prohibition on engaging in any activity that would require the company to register or obtain a license as a real estate agent or broker, was included in the FDIC’s second NPR.

The prohibition on engaging in any activity that would require the company to register or obtain a license as a real estate agent or broker prevents bank holding companies from engaging in any real estate brokerage or property management activities. In the FDIC’s second NPR, the FDIC proposed removing this condition from the description of finder activities in the definition of “financial activities.”

The FDIC received no comments addressing the proposed inclusion of these conditions in the FDIC’s second NPR. After reviewing the conditions contained in the definition of finder activities in the FDIC’s second NPR and consulting with the Board of Governors, the FDIC has determined that the prohibition on engaging in any activity that would require the company to register or obtain a license as a real estate agent or broker is definitional. Consequently, this condition has been restored in the final rule. While neither real estate brokerage nor real estate management are financial activities under section 4(k), a company may engage in such activities and still be predominantly engaged in the financial activity of acting as a finder. Under the final rule, only revenues associated with this latter activity will be considered financial for purposes of determining whether a firm is predominantly engaged in financial activities.

- ***Other activities***

As described above, section 4(k) of the BHC Act authorizes the Board of Governors, in consultation with the Secretary, to determine in the future that additional activities are “financial in nature or incidental thereto.”<sup>113</sup> One comment that was submitted in response to the Board of Governors’ second NPR suggested that the universe of financial activities that should be included when calculating either the revenue or assets test<sup>114</sup> should be frozen as of the date on which the Act was passed and should not include additional activities that the Board of Governors, in consultation with the Secretary, determines in the future to be “financial in nature or incidental thereto.”

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<sup>113</sup> See 12 U.S.C. 1834(k)(1)-(k)(3).

<sup>114</sup> 12 U.S.C. 5831(a)(6) provides that a company is predominantly engaged in financial activities for purposes of Title I if 85 percent or more of the company assets are related to, or revenues are derived from, activities that are financial in nature for purposes of section 4(k) of the BHC Act.



This comment, which specifically addressed the Board of Governor's rulemakings under Title I, was also submitted to the FDIC in response to the FDIC's second NPR.

The activities listed in the final rule's definition of "financial activities" represent all of the activities that the Board of Governors has determined, to date, are financial in nature or incidental thereto for purposes of section 4(k), but without certain of the conditions that are imposed to ensure a bank holding company conducting the activity does so in a safe and sound manner or in compliance with other applicable law. In the interests of providing certainty, the FDIC believes that this comprehensive list is appropriate for determining if a company is predominantly engaged in financial activities for purposes of Title II. However, the FDIC also acknowledges that the definition of activities that are financial in nature or incidental thereto under section 4(k) is not static. If the Board of Governors determines in the future that other activities are financial in nature or incidental thereto for purposes of section 4(k), the FDIC can amend the definition of "financial activities" for purposes of Title II at that time. Accordingly, the provision incorporating section 4(k)(1) in the proposed definition of "financial activities" has been removed from the final rule.

### **3. Equity investments in unconsolidated entities**

The FDIC's first NPR included two rules of construction governing the application of the revenue tests to revenues attributable to a company's minority equity investments in unconsolidated entities. Under the first rule of construction, the FDIC proposed to attribute to a company all revenues derived from the company's equity investment in any unconsolidated company that itself is predominantly engaged in

financial activities.<sup>115</sup> This rule of construction would have required companies to determine whether 85 percent or more of an investee company's revenues were attributable to financial activities for purposes of determining whether to treat revenues related to unconsolidated minority investments as financial.

Under the second rule of construction, the FDIC proposed to permit (but not require) a company to treat as nonfinancial the revenues attributable to a limited amount of de minimis equity investments in unconsolidated companies without having to separately determine whether the investee company is itself predominantly engaged in financial activities.<sup>116</sup>

***First Rule of Construction: Unconsolidated Investments***

Some of the comments received by the FDIC expressed the view that requiring a company to determine whether unconsolidated investee companies are themselves predominantly engaged in financial activities would be unduly burdensome. One such commenter noted that situations may exist where an investing company will not have sufficient access to information about the business operations of an investee company to perform the required analysis. Another commenter recommended that the FDIC revise the first rule of construction to provide that a company may treat revenues derived from an unconsolidated investment as not financial for purposes of Title II if the company is unable to obtain the relevant information about the source of revenues of the investee company, including from publicly available information, to perform the required analysis. One commenter requested that the FDIC accept determinations made by

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<sup>115</sup> See § 308.8(d)(1) of the FDIC's first NPR.

<sup>116</sup> See § 308.8(d)(2) of the FDIC's first NPR.

investing companies, provided such determinations are based on good-faith efforts.

Another commenter expressed concern that the “look-through” feature of the first rule of construction would complicate the calculation of the 85-percent total consolidated revenue test for funds and other companies that generally make non-controlling unconsolidated investments. This commenter requested that the FDIC accept determinations made by investors so long as such determinations are based on good-faith efforts.

One commenter expressed concern that any securitization trust or special purpose fund that pools and services (or arranges for the servicing of) any number of assets classes could be considered “predominantly engaged” for purposes of the FDIC’s first NPR. The commenter argued that such a rule would deter investment in asset-backed securities and securities issued by investment funds that are not debt in form, requesting that a third rule of construction be added that would permit a company to treat revenues it derives from any equity investments in an unconsolidated investee company as not derived from financial activities if such investee company is a securitization trust or a special purpose fund that directly or indirectly holds and services (or arranges for the servicing of) pools of specified asset classes.

The first rule of construction contained in the FDIC’s first NPR mirrored the first rule of construction proposed in the Board of Governors’ first NPR. The Board of Governors received comments asserting that a company’s minority equity investments in an unconsolidated company should not be included in a company’s financial revenues or assets when determining whether such company is predominantly engaged in financial activities for purposes of Title I unless the investment was made in connection with a

merchant banking investment as defined in section 4(k) or was made in a subsidiary of the company. Some commenters also viewed as burdensome the requirement to determine whether an investee company is itself predominantly engaged in financial activities. In light of those comments, the Board of Governors eliminated the requirement that a company determine whether an unconsolidated company in which it has made an investment is predominantly engaged in financial activities in the Board of Governors' final rule. In its place, the Board of Governors' final rule provided that an investment in an unconsolidated company will be presumed to be made in the course of conducting a financial activity set forth in section 4(k). The Board of Governors' final rule also permits a company to rebut the presumption that an investment in a particular unconsolidated company is related to a financial activity by providing evidence to (i) the Financial Stability Oversight Council ("Council"), with respect to the definition of a nonbank financial company for purposes of Title I of the Act (other than with respect to the definition of a significant nonbank financial company), or (ii) the Board of Governors, with respect to the definition of a significant nonbank financial company, that the investment is not a merchant banking investment, an investment for others, an investment in a company engaged in activities that are financial in nature, or is not otherwise related to a financial activity. The preamble to the Board of Governors' final rule clarified that such evidence would be considered on a case-by-case basis to determine whether the revenues derived from, or the assets related to, a company's investment in an unconsolidated company should be considered to be financial revenues or assets of the company.

After reviewing the comments received and considering the Board of Governors' final rule, the FDIC also has eliminated the first rule of construction as proposed in the FDIC's first NPR. For purposes of the final rule, a company's revenues derived from an investment in an unconsolidated entity will be treated as revenues derived from a financial activity unless the recommending agencies or the Secretary, as applicable, determine otherwise based on information to the contrary that they have at the time that the recommendation and determination are made under section 203 of the Act. The FDIC believes that most companies that derive a significant portion of revenue from investments in unconsolidated companies (such as hedge funds, private equity funds, or mutual funds) generally hold those investments for purposes of resale, make those investments in connection with the activity of investing for others, or invest in companies engaged in financial activities. Such investments will typically be made in the course of conducting one of the financial activities listed in section 4(k) (e.g., (i) bona fide merchant banking activity under section 4(k)(4)(H); (ii) an investment made for others as defined in section 4(k)(4)(A); or (iii) an investment in a company engaged in activities that are financial in nature). The FDIC also believes that this approach will reduce burden on companies by allowing them to determine whether they may be predominantly engaged in financial activities for purposes of Title II without having to determine whether an unconsolidated company in which it has invested is itself predominantly engaged in financial activities.

Unlike the rebuttable presumption contained within the Board of Governors' final rule, this final rule generally treats revenues derived from investments in unconsolidated entities as revenues derived from financial activities by definition. The FDIC believes

that this approach is necessary given the nature of the orderly liquidation authority including, specifically, the need for expeditious action under Title II. Title II is intended to resolve in an orderly, yet expeditious manner, companies that are in default or in danger of default and whose failure could have serious adverse effects on the U.S. financial system. The determinations to be made by the recommending agencies and the Secretary necessarily must be made quickly if those serious adverse effects are to be avoided. It is important to note, in this regard, that Title II provides for expedited judicial review of any determination that a company is a “financial company.” For companies other than bank holding companies and nonbank financial companies supervised by the Board of Governors this review would likely include an examination of whether the company meets one of the revenue tests and is appropriately considered a financial company.

The FDIC believes that this approach would also address investments in securitization trusts and special purpose funds that directly or indirectly hold and service pools of specified asset classes because such investments would likely qualify as one or more of the activities listed in the definition of “financial activities” in the final rule. For this reason, the FDIC did not adopt an additional rule of construction to exempt such investments.

The final rule also clarifies that the FDIC’s treatment of revenues derived from a company’s investment in an unconsolidated company is not dependent on whether the investment would constitute a “minority” investment under applicable accounting standards. This approach is intended to address circumstances in which an investor holds more than a majority of an investee company’s voting shares but has granted substantive

participating rights or similar rights to minority shareholders and, therefore, does not have a controlling financial interest under applicable accounting standards.

***Second Rule of Construction: De Minimis Investments***

As noted above, the FDIC's first NPR contained a second rule of construction that would permit, but not require, a company to treat as nonfinancial the revenues attributable to investments in unconsolidated companies representing less than five percent of any class of outstanding voting shares, and less than 25 percent of the total equity, of the unconsolidated company without having to separately determine whether those companies are themselves predominantly engaged in financial activities.<sup>117</sup> This rule of construction was subject to several conditions designed to limit the potential for these de minimis investments to substantially alter the financial character of the activities of a company.<sup>118</sup>

In light of the FDIC's modifications to the first rule of construction, the second rule of construction is no longer necessary and the FDIC has removed the second rule of construction from the final rule.

**4. Appropriate accounting standards**

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<sup>117</sup> See § 308.8(d)(2) of the FDIC's first NPR.

<sup>118</sup> Specifically, this rule of construction provided that a company may treat revenues derived from an equity investment by the company in an investee company as revenues not derived from activities that are financial in nature or incidental thereto (regardless of the type of activities conducted by the other company), if (i) the company owns less than five percent of any class of outstanding voting shares, and less than 25 percent of the total equity, of the investee company; (ii) the financial statements of the investee company are not consolidated with those of the company under applicable accounting standards; (iii) the company's investment in the investee company is not held in connection with the conduct of any financial activity (such as, for example, investment advisory activities or merchant banking investment activities) by the company or any of its subsidiaries; (iv) the investee company is not a bank, bank holding company, broker-dealer, insurance company, or other regulated financial institution; and (v) the aggregate amount of revenues treated as nonfinancial under the rule of construction in any year does not exceed five percent of the company's total consolidated financial revenues.

“Applicable accounting standards” was defined in the FDIC’s first NPR to mean the accounting standards that a company uses in the ordinary course of business in preparing its consolidated financial statements, provided those standards are: (i) U.S. generally accepted accounting principles (“GAAP”); (ii) International Financial Reporting Standards (“IFRS”); or (iii) such other accounting standards that the FDIC determines to be appropriate.<sup>119</sup> In determining whether an accounting standard other than GAAP or IFRS is appropriate, various factors will be considered, including whether the accounting standard is used by the company in the ordinary course of its business in preparing its consolidated financial statements. Reliance on an accounting standard that the company uses in the ordinary course of business reduces the potential for companies to change the outcome of the 85 percent revenue test by changing the accounting standards used for these purposes.

One commenter requested that the FDIC provide in the final rule that, in all cases, the “applicable accounting standards” will be the standards “utilized by the company in the ordinary course of business” unless the accounting standards in question have been designated as inappropriate by the FDIC. One commenter noted that allowing companies to use their consolidated year-end financial statements prepared in accordance with GAAP, or its functional equivalent, as the basis for determining their total consolidated revenue, allows the FDIC to compare such amounts across a broad spectrum of companies. This commenter also noted that this approach would facilitate the ability of companies to determine whether they are financial companies for the purposes of the Act. The FDIC agrees that this methodology is likely to provide a transparent, practical, and

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<sup>119</sup>See § 380.8(b)(3) of the FDIC’s first NPR.



comparable basis for determining such amounts across companies and, thus, should facilitate the ability of a company, the recommending agencies, and the Secretary to determine whether a company is a financial company for purposes of Title II. Moreover, allowing companies to use the year-end consolidated financial statements that they already prepare for financial reporting or other purposes should help reduce potential burden.

A number of commenters noted that insurance companies are not required by applicable insurance law or regulation to prepare financial statements in accordance with GAAP. Two such commenters suggested that certain insurance companies, including mutual and fraternal insurance companies, prepare their financial statements in accordance with Statutory Accounting Principles (“SAP”). One commenter noted that the rules governing SAP are developed by the National Association of Insurance Commissioners, which promulgates comprehensive accounting guidelines that are then implemented under state law and state insurance regulations. This commenter also suggested that SAP-based accounting is generally more conservative than GAAP-based accounting. These commenters recommended that the final rule include, with respect to insurance companies, SAP under the definition of “applicable accounting standards.”

To avoid unintended consequences that could arise as a result of differences between SAP and GAAP with respect to consolidation, section 380.8(b) in the final rule does not expressly list SAP within the definition of “applicable accounting standards.” Nonetheless, the FDIC believes that the use of SAP as an accounting standard may be appropriate in certain circumstances and that if such a circumstance occurs, it can be

appropriately addressed under section 380.8(b)(1)(iii) of the final rule.<sup>120</sup> However, the final rule removes the reference to the FDIC in that provision. The reason for that change is that, consistent with section 203 of the Act, it is not solely the FDIC that will determine whether the use of any other standard is appropriate. Rather, it is the recommending agencies, for purposes of their evaluations, and the Secretary, for purposes of the Secretary's determination who will determine whether the use of any other standard is appropriate.

## **5. Timing of Determination**

The final rule, like the FDIC's first NPR, provides flexibility, in appropriate circumstances, to consider whether a company meets the statutory definition of predominantly engaged in activities that are financial in nature or incidental thereto based on the full range of information that may be available concerning the company's activities (including information obtained from other Federal or state financial supervisors or agencies) at any time rather than only as reflected in the company's year-end consolidated financial statements.

For example, the FDIC notes that the mix of a company's revenues, as well as the risks the company could pose to the U.S. financial system, may change significantly and quickly as a result of various types of transactions or actions, such as a merger, consolidation, acquisition, establishment of a new business line, or the initiation of a new activity. Moreover, these transactions and actions may occur at any time during a company's fiscal year and, accordingly, the effects of the transactions or actions may not

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<sup>120</sup> The ordering of the definitions listed in § 380.8(b) has been modified from the FDIC's first NPR. The final rule lists the definitions in alphabetical order.

be reflected in the year-end consolidated financial statements of the company for several months.

The FDIC believes that the final rule appropriately takes into account the effect of changes in the nature or mix of a company's activities as a result of such transactions or actions where such changes may affect the determination of the Secretary as to whether the company is a financial company for purposes of the orderly liquidation authority under Title II.

### **III. Administrative Law Matters.**

#### *A. Paperwork Reduction Act*

In accordance with the requirements of the Paperwork Reduction Act of 1995, 44 U.S.C. 3501 et seq., the FDIC may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget ("OMB") control number. This final rule does not involve any new collections of information pursuant to the Paperwork Reduction Act. Consequently, no information has been submitted to the Office of Management and Budget for review.

#### *B. Regulatory Flexibility Act*

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601 et seq., generally requires an agency to consider whether a final rule will have a significant economic impact on a substantial number of small entities. The agency must prepare and publish a final regulatory flexibility analysis with respect to the potential significant economic impact.

Pursuant to section 605(b) of the RFA, the final regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.

The FDIC has considered the potential impact of the final rule on small entities in accordance with the RFA. Pursuant to section 605 of the RFA, the FDIC certifies that the final rule will not have a significant impact on a substantial number of small entities. The final rule only establishes definitional criteria for calculating revenues to determine whether a company is “predominantly engaged in activities that the Board of Governors has determined are financial in nature or incidental thereto” for purposes of determining whether a company is a “financial company” under Title II of the Dodd-Frank Act. Moreover, it does not subject any company to a Title II resolution.

Additionally, to be eligible to be designated as a “covered financial company” and subject to the orderly liquidation provisions of Title II, a company must satisfy, among other criteria, the definition of “financial company.” Importantly, a “financial company” is not automatically subject to the orderly liquidation authority provisions of Title II. Only a financial company for which a systemic risk determination has been made under section 203 of the Act is a “covered financial company” subject to the orderly liquidation authority under Title II. Under section 203(b) of the Act, a determination by the Secretary that a financial company satisfies the criteria for designation as a “covered financial company” requires, among other things, a determination that the failure of the financial company and its resolution under otherwise applicable Federal or State law would have serious adverse effects on financial stability in the United States. Although asset size may not be the only factor relevant to that determination, it is an important

consideration. Under the regulations of the Small Business Administration (SBA), firms within the “Finance and Insurance” sector are considered “small” if they have asset sizes that vary from \$7 million or less in assets to \$175 million or less in assets.<sup>121</sup> It is unlikely that a determination would be made that a financial company at or below these size thresholds is a “covered financial company,” given the above-referenced criterion that must be satisfied under Section 203(b). In addition, as described in the Supplementary Information section of this preamble, the FDIC has taken steps to reduce the potential burden of the final rule on companies that may be affected by the final rule.

One commenter expressed the view that although it is unlikely that companies with less than \$175 million in assets would be subject to the orderly liquidation process under Title II, in the event that a money market mutual fund were determined to be a covered financial company, small businesses, municipal entities, and small non-profit organizations that invest in the fund would be face higher costs. The commenter asserted that the RFA requires the FDIC to perform a cost-benefit analysis of its proposed rules because the RFA applies even in those instances in which a regulation does not directly apply to an entity, but directly affects it.<sup>122</sup>

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<sup>121</sup> See 13 CFR 121.201.

<sup>122</sup> The commenter cited to Aeronautical Repair Station Ass’n, Inc. v. FAA, 494 F.3d 161, 177 (D.C. Cir. 2007). In that case, the FAA regulation at issue required employees who performed certain functions “directly or by contract (including by subcontract at any tier)” to be subject to drug and alcohol testing. The commenter stated that the “court rejected arguments that an RFA analysis was unnecessary because contractors of air carriers were not “directly regulated” and were not the “targets” of the regulation. The commenter asserted that the court held that contractors were “subject to the proposed regulation” for purposes of RFA even though the regulation was “immediately addressed” to the air carriers, because the regulations applied to employees of the air carriers. The contractors were “directly affected and therefore regulated” within the meaning of the RFA.

The question of whether the RFA requires consideration of the indirect application of a rule has been considered by the courts, which have held that the RFA only requires an analysis of how a rule affects small entities that would be directly subject to its requirements.<sup>123</sup> As described above, the final rule establishes criteria for determining if a company is “predominantly engaged in activities that are financial in nature or incidental thereto” for purposes of Title II. The final rule does not impose requirements directly on any entity.<sup>124</sup> Moreover, as noted above, it is unlikely that a company with less than \$175 million in assets would be a “covered financial company” under Title II. As such, the FDIC believes that the final rule will not have a significant impact on a substantial number of small entities.

The same commenter also asserted that the FDIC is required to perform a cost benefit analysis under Executive Order 13579. The Executive Order cited does not mandate that independent agencies such as the FDIC perform cost benefit analysis of their regulations. However, the FDIC takes seriously the importance of evaluating the burdens imposed by its rulemaking efforts. For example, the FDIC seeks to adopt final

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<sup>123</sup> See Mid-Tex Elec. Coop v. FERC, 773 F.2d 327 (D.C. Cir. 1985) and American Trucking Ass’ns v. EPA, 175 F.3d 1027, 1044 (D.C. Cir. 1999), aff’d in part and rev’d in part on other ground, Whitman v. American Trucking Ass’ns, 531 U.S. 475 (2001). In Mid-Tex, the court rejected the argument that “RFA is intended to apply to all rules that affect small entities, whether the small entities are directly regulated or not,” and held that the RFA requires agencies to consider the “economic impact” of a regulation on “a substantial number of small entities that are subject to the requirements” of the regulation. See 773 F.2d at 342 (emphasis added). The court further stated that “Congress did not intend to require that every agency consider every indirect effect that any regulation might have on small business in any stratum of the national economy.” See id. At 343. The court in Aeronautical Repair Station, the case cited by the commenter, distinguished Mid-Tex and its progeny from the facts in that case, in which the regulations at issue “expressly require[d] that the employees of contractors and subcontractors be tested” for drug and alcohol use. See 494 F.3d at 177. For this reason, the court in Aeronautical Repair Station found that the rule at issue “impose[d] responsibilities directly on the contractors and subcontractors and they [we]re therefore parties affected by and regulated by it.” See id. (emphasis added).

<sup>124</sup> 12 U.S.C. 5383(b).

rules that faithfully reflect the statutory provisions and Congressional intent while minimizing regulatory burden. As described above, the FDIC considered the potential impact of the final rule on small entities and certified that the final rule will not have a significant impact on a substantial number of small entities. In addition, since the final rule does not involve any new collections of information, no PRA analysis is required.

#### *C. Small Business Regulatory Enforcement Fairness Act*

The Office of Management and Budget has determined that the final rule is not a “major rule” within the meaning of the Small Business Regulatory Enforcement Fairness Act of 1996 (“SBREFA”), 5 U.S.C. 801 et seq. As required by the SBREFA, the FDIC will file the appropriate reports with Congress and the General Accounting Office so that the final rule will be reviewed.

#### *D. Plain Language*

Section 722 of the Gramm-Leach-Bliley Act (Pub. L. 106-102, 113 Stat. 1338, 1471) requires the FDIC to use plain language in all proposed and final rules published after January 1, 2000. In light of this requirement, the FDIC has sought to present the final rule in a simple and straightforward manner.

### **Text of the Final Rule**

### **List of Subjects in 12 CFR Part 380**

Holding companies, Insurance companies.

## **Authority and Issuance**

For the reasons set forth in the Supplementary Information, the Federal Deposit Insurance Corporation amends Part 380 of Chapter III of Title 12, Code of Federal Regulations as follows:

### **PART 380 —ORDERLY LIQUIDATION AUTHORITY**

1. Revise the authority citation for part 380 to read as follows:

**Authority:** 12 U.S.C. 5389; 12 U.S.C. 5390(s)(3); 12 U.S.C. 5390(b)(1)(C); 12 U.S.C. 5390(a)(7)(D); 12 U.S.C. 5381(b).

2. Add § 380.8 to read as follows:

#### **§ 380.8 Predominantly engaged in activities that are financial or incidental thereto.**

(a) For purposes of sections 201(a)(11) and 201(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>1</sup> (“Dodd-Frank Act”) and this part, a company is predominantly engaged in activities that the Board of Governors of the Federal Reserve System (“Board of Governors”) has determined are financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act of 1956 (“BHC Act”) (12 U.S.C. 1843(k)), if:

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<sup>1</sup> 12 U.S.C. 5381(a)(11) and (b).



(1) At least 85 percent of the total consolidated revenues of such company (determined in accordance with applicable accounting standards) for either of its two most recently completed fiscal years were derived, directly or indirectly, from financial activities, or

(2) Based upon all of the relevant facts and circumstances, the consolidated revenues of the company from financial activities constitute 85 percent or more of the total consolidated revenues of the company.

(b) For purposes of paragraph (a) of this section, the following definitions apply:

(1) The term “applicable accounting standards” means the accounting standards utilized by the company in the ordinary course of business in preparing its consolidated financial statements, provided that those standards are:

(i) U.S. generally accepted accounting principles,

(ii) International Financial Reporting Standards, or

(iii) Such other accounting standards that are determined to be appropriate on a case-by-case basis.

(2) The terms “broker” and “dealer” have the same meanings as in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c).

(3) The term “financial activity” means:

(i) Lending, exchanging, transferring, investing for others, or safeguarding money or securities.

(ii) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any state.

(iii) Providing financial, investment, or economic advisory services, including advising an investment company (as defined in section 3 of the Investment Company Act of 1940).

(iv) Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly.

(v) Underwriting, dealing in, or making a market in securities.

(vi) Engaging in any activity that the Board of Governors has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto, which include –

(A) Extending credit and servicing loans. Making, acquiring, brokering, or servicing loans or other extensions of credit (including factoring, issuing letters of credit and accepting drafts) for the company’s account or for the account of others.

(B) Activities related to extending credit. Any activity usual in connection with making, acquiring, brokering or servicing loans or other extensions of credit, including the following activities -

(1) Real estate and personal property appraising. Performing appraisals of real estate and tangible and intangible personal property, including securities.

(2) Arranging commercial real estate equity financing. Acting as intermediary for the financing of commercial or industrial income-producing real estate by arranging for the transfer of the title, control, and risk of such a real estate project to one or more investors.

(3) Check-guaranty services. Authorizing a subscribing merchant to accept personal checks tendered by the merchant's customers in payment for goods and services, and purchasing from the merchant validly authorized checks that are subsequently dishonored.

(4) Collection agency services. Collecting overdue accounts receivable, either retail or commercial.

(5) Credit bureau services. Maintaining information related to the credit history of consumers and providing the information to a credit grantor who is considering a borrower's application for credit or who has extended credit to the borrower.

(6) Asset management, servicing, and collection activities. Engaging under contract with a third party in asset management, servicing, and collection<sup>2</sup> of assets of a type that an insured depository institution may originate and own.

(7) Acquiring debt in default. Acquiring debt that is in default at the time of acquisition.

(8) Real estate settlement servicing. Providing real estate settlement services.<sup>3</sup>

(C) Leasing personal or real property. Leasing personal or real property or acting as agent, broker, or adviser in leasing such property if –

(1) The lease is on a nonoperating basis;<sup>4</sup>

(2) The initial term of the lease is at least 90 days; and

(3) In the case of leases involving real property:

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<sup>2</sup> Asset management services include acting as agent in the liquidation or sale of loans and collateral for loans, including real estate and other assets acquired through foreclosure or in satisfaction of debts previously contracted.

<sup>3</sup> For purposes of this section, real estate settlement services do not include providing title insurance as principal, agent, or broker.

<sup>4</sup> The requirement that the lease is on a nonoperating basis means that the company does not, directly or indirectly, engage in operating, servicing, maintaining, or repairing leased property during the lease term. For purposes of the leasing of automobiles, the requirement that the lease is on a nonoperating basis means that the company does not, directly or indirectly: (1) provide servicing, repair, or maintenance of the leased vehicle during the lease term; (2) purchase parts and accessories in bulk or for an individual vehicle after the lessee has taken delivery of the vehicle; (3) provide the loan of an automobile during servicing of the leased vehicle; (4) purchase insurance for the lessee; or (5) provide for the renewal of the vehicle's license merely as a service to the lessee where the lessee could renew the license without authorization from the lessor.

(i) At the inception of the initial lease, the effect of the transaction will yield a return that will compensate the lessor for not less than the lessor's full investment in the property plus the estimated total cost of financing the property over the term of the lease from rental payments, estimated tax benefits, and the estimated residual value of the property at the expiration of the initial lease; and

(ii) The estimated residual value of property for purposes of paragraph (b)(2)(vi)(C)(3)(i) of this section shall not exceed 25 percent of the acquisition cost of the property to the lessor.

(D) Operating nonbank depository institutions— (1) Industrial banking. Owning, controlling, or operating an industrial bank, Morris Plan bank, or industrial loan company that is not a bank for purposes of the BHC Act.

(2) Operating savings associations. Owning, controlling, or operating a savings association.

(E) Trust company functions. Performing functions or activities that may be performed by a trust company (including activities of a fiduciary, agency, or custodial nature), in the manner authorized by federal or state law that is not a bank for purposes of section 2(c) of the BHC Act.

(F) Financial and investment advisory activities. Acting as investment or financial advisor to any person, including (without, in any way, limiting the foregoing):

(1) Serving as investment adviser (as defined in section 2(a)(20) of the Investment Company Act of 1940, 15 U.S.C. 80a-2(a)(20)), to an investment company registered under that act, including sponsoring, organizing, and managing a closed-end investment company;

(2) Furnishing general economic information and advice, general economic statistical forecasting services, and industry studies;

(3) Providing advice in connection with mergers, acquisitions, divestitures, investments, joint ventures, leveraged buyouts, recapitalizations, capital structurings, financing transactions and similar transactions, and conducting financial feasibility studies;<sup>5</sup>

(4) Providing information, statistical forecasting, and advice with respect to any transaction in foreign exchange, swaps, and similar transactions, commodities, and any forward contract, option, future, option on a future, and similar instruments;

(5) Providing educational courses, and instructional materials to consumers on individual financial management matters; and

(6) Providing tax-planning and tax-preparation services to any person.

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<sup>5</sup> Feasibility studies do not include assisting management with the planning or marketing for a given project or providing general operational or management advice.

(G) Agency transactional services for customer investments— (I) Securities brokerage.

Providing securities brokerage services (including securities clearing and/or securities execution services on an exchange), whether alone or in combination with investment advisory services, and incidental activities (including related securities credit activities and custodial services).

(2) Riskless principal transactions. Buying and selling in the secondary market all types of securities on the order of customers as a “riskless principal” to the extent of engaging in a transaction in which the company, after receiving an order to buy (or sell) a security from a customer, purchases (or sells) the security for its own account to offset a contemporaneous sale to (or purchase from) the customer.

(3) Private placement services. Acting as agent for the private placement of securities in accordance with the requirements of the Securities Act of 1933 (“1933 Act”) and the rules of the Securities and Exchange Commission.

(4) Futures commission merchant. Acting as a futures commission merchant (“FCM”) for unaffiliated persons in the execution, clearance, or execution and clearance of any futures contract and option on a futures contract.

(5) Other transactional services. Providing to customers as agent transactional services with respect to swaps and similar transactions, any transaction described in paragraph (b)(2)(vi)(H) of this section, any transaction that is permissible for a state member bank, and any other

transaction involving a forward contract, option, futures, option on a futures or similar contract (whether traded on an exchange or not) relating to a commodity that is traded on an exchange.

(H) Investment transactions as principal —(I) Underwriting and dealing in government obligations and money market instruments. Underwriting and dealing in obligations of the United States, general obligations of states and their political subdivisions, and other obligations that state member banks of the Federal Reserve System may be authorized to underwrite and deal in under 12 U.S.C. 24 and 335, including banker's acceptances and certificates of deposit.

(2) Investing and trading activities. Engaging as principal in:

(i) Foreign exchange;

(ii) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on any rate, price, financial asset (including gold, silver, platinum, palladium, copper, or any other metal), nonfinancial asset, or group of assets, other than a bank-ineligible security<sup>6</sup>, if: a state member bank is authorized to invest in the asset underlying the contract; the contract requires cash settlement; the contract allows for assignment, termination, or offset prior to delivery or expiration, and the company makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract, or receives and instantaneously transfers title to the underlying asset, by operation of contract and

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<sup>6</sup> A bank-ineligible security is any security that a state member bank is not permitted to underwrite or deal in under 12 U.S.C. 24 and 335.



without taking or making physical delivery of the asset; or the contract does not allow for assignment, termination, or offset prior to delivery or expiration and is based on an asset for which futures contracts or options on futures contracts have been approved for trading on a U.S. contract market by the Commodity Futures Trading Commission, and the company makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract, or receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset.

(iii) Forward contracts, options,<sup>7</sup> futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on an index of a rate, a price, or the value of any financial asset, nonfinancial asset, or group of assets, if the contract requires cash settlement.

(3) Buying and selling bullion, and related activities. Buying, selling and storing bars, rounds, bullion, and coins of gold, silver, platinum, palladium, copper, and any other metal for the company's own account and the account of others, and providing incidental services such as arranging for storage, safe custody, assaying, and shipment.

(I) Management consulting and counseling activities— (I) Management consulting. Providing management consulting advice:<sup>8</sup>

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<sup>7</sup> This reference does not include acting as a dealer in options based on indices of bank-ineligible securities when the options are traded on securities exchanges. These options are securities for purposes of the federal securities laws and bank-ineligible securities for purposes of section 20 of the Glass-Steagall Act, 12 U.S.C. 337. Similarly, this reference does not include acting as a dealer in any other instrument that is a bank-ineligible security for purposes of section 20. Bank holding companies that deal in these instruments must do so in accordance with the Board of Governor's orders on dealing in bank-ineligible securities.

(i) On any matter to unaffiliated depository institutions, including commercial banks, savings and loan associations, savings banks, credit unions, industrial banks, Morris Plan banks, cooperative banks, industrial loan companies, trust companies, and branches or agencies of foreign banks;

(ii) On any financial, economic, accounting, or audit matter to any other company.

(2) Revenues derived from a company's management consulting activities under this paragraph (b)(3)(vi) will not be considered to be financial if the company:

(i) Owns or controls, directly or indirectly, more than 5 percent of the voting securities of the client institution; or

(ii) Allows a management official, as defined in 12 CFR 212.2(h), of the company or any of its affiliates to serve as a management official of the client institution, except where such interlocking relationship is permitted pursuant to an exemption permitted by the Board of Governors.

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<sup>8</sup> In performing this activity, companies are not authorized to perform tasks or operations or provide services to client institutions either on a daily or continuing basis, except as necessary to instruct the client institution on how to perform such services for itself. See also the Board of Governors' interpretation of bank management consulting advice (12 CFR 225.131).

(3) Up to 30 percent of a nonbank company's revenues related to management consulting services provided to customers not described in paragraph (b)(3)(vi)(I)(I)(i) or regarding matters not described in paragraph (b)(3)(vi)(I)(I)(ii) of this section will be included in the company's financial revenues.

(4) Employee benefits consulting services. Providing consulting services to employee benefit, compensation and insurance plans, including designing plans, assisting in the implementation of plans, providing administrative services to plans, and developing employee communication programs for plans.

(5) Career counseling services. Providing career counseling services to:

(i) A financial organization<sup>9</sup> and individuals currently employed by, or recently displaced from, a financial organization;

(ii) Individuals who are seeking employment at a financial organization; and

(iii) Individuals who are currently employed in or who seek positions in the finance, accounting, and audit departments of any company.

(J) Support services— (I) Courier services. Providing courier services for:

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<sup>9</sup> Financial organization refers to insured depository institution holding companies and their subsidiaries, other than nonbanking affiliates of diversified savings and loan holding companies that engage in activities not permissible under section 4(c)(8) of the BHC Act (12 U.S.C. 1842(c)(8)).

(i) Checks, commercial papers, documents, and written instruments (excluding currency or bearer-type negotiable instruments) that are exchanged among banks and financial institutions; and

(ii) Audit and accounting media of a banking or financial nature and other business records and documents used in processing such media.<sup>10</sup>

(2) Printing and selling MICR-encoded items. Printing and selling checks and related documents, including corporate image checks, cash tickets, voucher checks, deposit slips, savings withdrawal packages, and other forms that require Magnetic Ink Character Recognition (MICR) encoding.

(K) Insurance agency and underwriting— (I) Credit insurance. Acting as principal, agent, or broker for insurance (including home mortgage redemption insurance) that is:

(i) Directly related to an extension of credit by the company or any of its subsidiaries; and

(ii) Limited to ensuring the repayment of the outstanding balance due on the extension of credit<sup>11</sup> in the event of the death, disability, or involuntary unemployment of the debtor.

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<sup>10</sup> See also the Board of Governors' interpretation on courier activities (12 CFR 225.129), which sets forth conditions for company entry into the activity.

(2) Finance company subsidiary. Acting as agent or broker for insurance directly related to an extension of credit by a finance company<sup>12</sup> that is a subsidiary of a company, if:

(i) The insurance is limited to ensuring repayment of the outstanding balance on such extension of credit in the event of loss or damage to any property used as collateral for the extension of credit; and

(ii) The extension of credit is not more than \$10,000, or \$25,000 if it is to finance the purchase of a residential manufactured home<sup>13</sup> and the credit is secured by the home; and

(iii) The applicant commits to notify borrowers in writing that: they are not required to purchase such insurance from the applicant; such insurance does not insure any interest of the borrower in the collateral; and the applicant will accept more comprehensive property insurance in place of such single-interest insurance.

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<sup>11</sup> Extension of credit includes direct loans to borrowers, loans purchased from other lenders, and leases of real or personal property so long as the leases are nonoperating and full-payout leases that meet the requirements of paragraph (b)(2)(vi)(C) of this section.

<sup>12</sup> Finance company includes all non-deposit-taking financial institutions that engage in a significant degree of consumer lending (excluding lending secured by first mortgages) and all financial institutions specifically defined by individual states as finance companies and that engage in a significant degree of consumer lending.

<sup>13</sup> These limitations increase at the end of each calendar year, beginning with 1982, by the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published by the Bureau of Labor Statistics.

(3) Insurance in small towns. Engaging in any insurance agency activity in a place where the company or a subsidiary has a lending office and that:

(i) Has a population not exceeding 5,000 (as shown in the preceding decennial census); or

(ii) Has inadequate insurance agency facilities, as determined by the Board of Governors, after notice and opportunity for hearing.

(4) Insurance-agency activities conducted on May 1, 1982. Engaging in any specific insurance-agency activity<sup>14</sup> if the company, or subsidiary conducting the specific activity, conducted such activity on May 1, 1982, or received approval from the Board of Governors to conduct such activity on or before May 1, 1982.<sup>15</sup> Revenues derived from a company's specific insurance agency activity under this clause will be considered financial only if the company:

(i) Engages in such specific insurance agency activity only at locations: in the state in which the company has its principal place of business (as defined in 12 U.S.C. 1842(d)); in any state or states immediately adjacent to such state; and in any state in which the specific insurance-

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<sup>14</sup> Nothing contained in this provision precludes a subsidiary that is authorized to engage in a specific insurance-agency activity under this clause from continuing to engage in the particular activity after merger with an affiliate, if the merger is for legitimate business purposes.

<sup>15</sup> For the purposes of this paragraph, activities engaged in on May 1, 1982, include activities carried on subsequently as the result of an application to engage in such activities pending before the Board of Governors on May 1, 1982, and approved subsequently by the Board of Governors or as the result of the acquisition by such company pursuant to a binding written contract entered into on or before May 1, 1982, of another company engaged in such activities at the time of the acquisition.

agency activity was conducted (or was approved to be conducted) by such company or subsidiary thereof or by any other subsidiary of such company on May 1, 1982; and

(ii) Provides other insurance coverages that may become available after May 1, 1982, so long as those coverages insure against the types of risks as (or are otherwise functionally equivalent to) coverages sold or approved to be sold on May 1, 1982, by the company or subsidiary.

(5) Supervision of retail insurance agents. Supervising on behalf of insurance underwriters the activities of retail insurance agents who sell:

(i) Fidelity insurance and property and casualty insurance on the real and personal property used in the operations of the company or its subsidiaries; and

(ii) Group insurance that protects the employees of the company or its subsidiaries.

(6) Small companies. Engaging in any insurance-agency activity if the company has total consolidated assets of \$50 million or less. Revenues derived from a company's insurance-agency activities under this paragraph will be considered financial only if the company does not engage in the sale of life insurance or annuities except as provided in paragraphs

(b)(3)(vi)(K)(I) and (3) of this section, and does not continue to engage in insurance-agency activities pursuant to this provision more than 90 days after the end of the quarterly reporting period in which total assets of the company and its subsidiaries exceed \$50 million.

(7) Insurance-agency activities conducted before 1971. Engaging in any insurance-agency activity performed at any location in the United States directly or indirectly by a company that was engaged in insurance-agency activities prior to January 1, 1971, as a consequence of approval by the Board of Governors prior to January 1, 1971.

(L) Community development activities —(1) Financing and investment activities. Making equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas by providing housing, services, or jobs for residents.

(2) Advisory activities. Providing advisory and related services for programs designed primarily to promote community welfare.

(M) Money orders, savings bonds, and traveler's checks. The issuance and sale at retail of money orders and similar consumer-type payment instruments; the sale of U.S. savings bonds; and the issuance and sale of traveler's checks.

(N) Data processing.

(1) Providing data processing, data storage and data transmission services, facilities (including data processing, data storage and data transmission hardware, software, documentation, or operating personnel), databases, advice, and access to such services, facilities, or databases by any technological means, if the data to be processed, stored or furnished are financial, banking or economic.



(2) Up to 30 percent of a nonbank company's revenues related to providing general purpose hardware in connection with providing data processing products or services described in (b)(2)(vi)(N)(I) of this section will be included in the company's financial revenues.

(O) Administrative services. Providing administrative and other services to mutual funds.

(P) Securities exchange. Owning shares of a securities exchange.

(Q) Certification authority. Acting as a certification authority for digital signatures and authenticating the identity of persons conducting financial and nonfinancial transactions.

(R) Employment histories. Providing employment histories to third parties for use in making credit decisions and to depository institutions and their affiliates for use in the ordinary course of business.

(S) Check cashing and wire transmission. Check cashing and wire transmission services.

(T) Services offered in connection with banking services. In connection with offering banking services, providing notary public services, selling postage stamps and postage-paid envelopes, providing vehicle registration services, and selling public transportation tickets and tokens.

(U) Real estate title abstracting.

(vii) Engaging, in the United States, in any activity that a bank holding company may engage in outside of the United States; and the Board has determined, under regulations prescribed or interpretations issued pursuant to section 4(c)(13) of the BHC Act of 1956 (12 U.S.C. 1843(c)(13)) to be usual in connection with the transaction of banking or other financial operations abroad. Those activities include—

- (A) Providing management consulting services, including to any person with respect to nonfinancial matters, so long as the management consulting services are advisory and do not allow the company to control the person to which the services are provided.
- (B) Operating a travel agency in connection with financial services.
- (C) Organizing, sponsoring, and managing a mutual fund.
- (D) Commercial banking and other banking activities.

(viii) (A) Acting as a finder in bringing together one or more buyers and sellers of any product or service for transactions that the parties themselves negotiate and consummate, including providing any or all of the following services through any means-

(1) Identifying potential parties, making inquiries as to interest, introducing, and referring potential parties to each other, and arranging contacts between and meetings of interested parties;

(2) Conveying between interested parties expressions of interest, bids, offers, orders and confirmations relating to a transaction; and

(3) Transmitting information conveying products and services to potential parties in connection with the activities described paragraphs (b)(3)(viii)(A)(1) and (2) of this section.

(B) The following are examples of finder services when done in accordance with paragraphs (b)(3)(viii)(C) – (D) of this section. These examples are not exclusive.

(1) Hosting an electronic marketplace on the company's Internet web site by providing hypertext or similar links to the web sites of third party buyers or sellers.

(2) Hosting on the company's servers the Internet web site of—

(i) A buyer (or seller) that provides information concerning the buyer (or seller) and the products or services it seeks to buy (or sell) and allows sellers (or buyers) to submit expressions of interest, bids, offers, orders and confirmations relating to such products or services; or

(ii) A government or government agency that provides the information concerning the services or benefits made available by government or government agency, assists persons in completing applications to receive such services or benefits from the government or agency, and allows persons to transmit their applications for services or benefits to the government or agency.

(3) Operating an Internet web site that allows multiple buyers and sellers to exchange information concerning the products and services that they are willing to purchase or sell, locate

potential counterparties for transactions, aggregate orders for goods or services with those made by other parties, and enter into transactions between themselves.

(4) Operating a telephone call center that provides permissible finder services.

(C) To be a finder service for purposes of this section, the company providing the service must comply with the following limitations.

(1) A company providing the service may act only as an intermediary between a buyer and a seller.

(2) A company providing the service may not bind any buyer or seller to the terms of a specific transaction or negotiate the terms of a specific transaction on behalf of a buyer or seller, except that the company may--

(i) Arrange for buyers to receive preferred terms from sellers so long as the terms are not negotiated as part of any individual transaction, are provided generally to customers or broad categories of customers, and are made available by the seller (and not by the company); and

(ii) Establish rules of general applicability governing the use and operation of the finder service, including rules that govern the submission of bids and offers by buyers and sellers that use the finder service and the circumstances under which the finder service will match bids and offers

submitted by buyers and sellers, and govern the manner in which buyers and sellers may bind themselves to the terms of a specific transaction.

(3) Services provided by a company will not be considered finder services if the company providing the service—

(i) Takes title to or acquires or holds an ownership interest in any product or service offered or sold through the finder service;

(ii) Provides distribution services for physical products or services offered or sold through the finder service;

(iii) Owns or operates any real or personal property that is used for the purpose of manufacturing, storing, transporting, or assembling physical products offered or sold by third parties; or

(iv) Owns or operates any real or personal property that serves as a physical location for the physical purchase, sale or distribution of products or services offered or sold by third parties.

(D) Services provided by a company will not be considered finder services if the company providing such services engages in any activity that would require the company to register or obtain a license as a real estate agent or broker under applicable law.

(E) To be a finder service for purposes of this section, a company providing the service must distinguish the products and services offered by the company from those offered by a third party through the finder service.

(ix) Directly, or indirectly acquiring or controlling, whether as principal, on behalf of one or more entities, or otherwise, shares, assets, or ownership interests (including debt or equity securities, partnership interests, trust certificates, or other instruments representing ownership) of a company or other entity, whether or not constituting control of such company or entity, engaged in any activity not financial in nature as defined in this section if:

(A) Such shares, assets, or ownership interests are acquired and held as part of a bona fide underwriting or merchant or investment banking activity, including investment activities engaged in for the purpose of appreciation and ultimate resale or disposition of the investment;

(B) Such shares, assets, or ownership interests are held for a period of time to enable the sale or disposition thereof on a reasonable basis consistent with the financial viability of the activities described in paragraph (b)(3)(ix)(A) of this section; and

(C) During the period such shares, assets, or ownership interests are held, the company does not routinely manage or operate such company or entity except as may be necessary or required to obtain a reasonable return on investment upon resale or disposition.

(x) Directly or indirectly acquiring or controlling, whether as principal, on behalf of one or more entities, or otherwise, shares, assets, or ownership interests (including debt or equity securities, partnership interests, trust certificates or other instruments representing ownership) of a company or other entity, whether or not constituting control of such company or entity engaged in any activity not financial in nature as defined in this section if—

(A) Such shares, assets, or ownership interests are acquired and held by an insurance company that is predominantly engaged in underwriting life, accident and health, or property and casualty insurance (other than credit-related insurance) or providing and issuing annuities;

(B) Such shares, assets, or ownership interests represent an investment made in the ordinary course of business of such insurance company in accordance with relevant State law governing such investments; and

(C) During the period such shares, assets, or ownership interests are held, the company does not routinely manage or operate such company except as may be necessary or required to obtain a reasonable return on investment.

(xi) Lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities.

(xii) Providing any device or other instrumentality for transferring money or other financial assets.

(xiii) Arranging, effecting, or facilitating financial transactions for the account of third parties.

(xiv) Ownership or control of one or more depository institutions.

(4) The term “recommending agencies” means:

(i) The Board of Governors and the Securities and Exchange Commission in consultation with the FDIC, for a company;

(A) That is a broker or a dealer; or

(B) Whose largest U.S. subsidiary is a broker or a dealer;

(ii) The Board of Governors and the Director of the Federal Insurance Office in consultation with the FDIC, for a company that is an “insurance company”, or whose largest U.S. subsidiary is an insurance company, as that term is defined in section 201(a)(13) of the Dodd-Frank Act<sup>16</sup>; and

(iii) The Board of Governors and the FDIC, for any other company.

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<sup>16</sup> 12 U.S.C. 5381(a)(13).



(5) The term “total consolidated revenues” means the total gross revenues of the company and all entities subject to consolidation by the company for a fiscal year.

(c) *Effect of other authority.* Any activity described in paragraph (b)(2) of this section is considered financial in nature or incidental thereto for purposes of this section regardless of whether—

(1) A bank holding company (including a financial holding company or a foreign bank) may be authorized to engage in the activity, or own or control shares of a company engaged in such activity, under any other provisions of the BHC Act or other Federal law including, but not limited to, section 4(a)(2), section 4(c)(5), section 4(c)(6), section 4(c)(7), section 4(c)(9), or section 4(c)(13) of the BHC Act (12 U.S.C. 1843(a)(2), (c)(5), (c)(6), (c)(7), (c)(9), or (c)(13)) and the Board of Governors’ implementing regulations; or

(2) Other provisions of Federal or state law or regulations prohibit, restrict, or otherwise place conditions on the conduct of the activity by a bank holding company (including a financial holding company or foreign bank) or bank holding companies generally.

(d) *Rule of construction.* Revenues derived from an investment by the company in an entity whose financial statements are not consolidated with those of the company will be treated as revenues derived from financial activities, unless such treatment is not appropriate based on

information that the recommending agencies or the Secretary, have at the time a written recommendation or determination is made under section 203 of the Dodd-Frank Act.

By order of the Board of Directors.

Dated at Washington, D.C., this 4th day of June, 2013

FEDERAL DEPOSIT INSURANCE CORPORATION

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Robert E. Feldman  
Executive Secretary

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